Harland Clarke Webcast 11/15/18
Attracting the Next Generation of Banking Relationships
TRANSCRIPT

Presenter Sheila Easley, Director of Strategy and Process, Harland Clarke
Presenter Alix Patterson, Partner, Callahan & Associates

Nathan: Good day, and welcome to Harland Clarke's *The Informed Banker* webcast, "Attracting the Next Generation of Banking Relationships." This webcast is being recorded and a replay will be provided to you within a few days. If you have questions, please use the question box located in the control panel. Your questions are private and are only seen by our presenters. Now, I will turn the call over to Sheila Easley of Harland Clarke. Sheila, you've got the call.

Sheila: Thanks, Nathan, and welcome to all who have joined us today for this Month's installment of *Informed Banker*. This series is designed to bring you succinct, timely information on topics that are critical to community financial institutions. Today's session, "Attracting the Next Generation of Banking Relationships," will be presented by Alix Patterson of Filene Research. She'll discuss the way consumers earn, spend, and think about financial decisions, and how community financial institutions can thrive in this rapidly changing environment. Alix is a Partner at Callahan & Associates. She's a lifelong credit union member and has over 15 years of professional credit union experience. Alix, we're thrilled to have you back. Now, I'll turn it over to you.

Alix: Thank you so much, Sheila. I appreciate that. The topic for today is to look at how are we going to attract the next generation of credit union members. Normally, when we talk about attracting the next generation of members, people think we're about to talk about FinTech and technology and how are we going to adapt our delivery channels to attract the consumers who now have such high expectations for how they can engage with a financial institution, but what I wanted to talk about today was slightly different. To think about the way that consumers earn, spend, and think about their financial decisions, and how that is shifting, and how local community institutions are the best-suited ones to respond to these shifts. We'll talk a little bit about technology, but that's not really the point today. I really want to talk about how Americans are changing the way they think about money, how they're thinking about what that means to you guys in trying to attract the next generation of banking relationships.

Let's go ahead to that slide that shows the traditional sequence of financial decisions. Historically, this was the way that small – or all banking relationships thought about a consumer. This was the traditional graduation through the pyramid of making big financial decisions. At some point, you have a part-time job. You're going to buy a car. You may go to college. You're going to enter the workforce. There are a number of dynamics that have shifted the way we – the way consumers are thinking about their finances. That means we as financial institutions need to change the way we are thinking about how we serve them. Next slide, please.

The first dynamic I wanted to talk about was the cost of higher education. I say that in a very deliberate way because a lot of the headlines today talk about the student loan crisis. In reality, it's the cost of higher education that is skyrocketing. Student loans have a purpose for enabling consumers to go to college, but there's a real challenge today when the cost of higher education is accelerating at a pace that's even double that of health care and health care you always see in the news as being one of the challenges for consumers. Today, there are 44 million Americans that hold over a trillion dollars in student loan debt. This means that people are delaying the decisions that they make about financial purchases.

If you go to the next slide, you'll see some data here from 2017 about student loan debt and housing and the way that the student loans have impacted peoples' decision-making priorities. You can see here that 76% have said that it has changed the way they think about purchasing a home, or taking a vacation is 72%, 65% said that it's delayed their purchase of a car. This is something that we need to consider. This isn't about technology; this is about a financial burden that many Americans, 44 million, are facing.

The second dynamic if we could go to the next slide is also about a shift in attitude. Today, consumers are thinking that access may be better than ownership. You'll see this in the rise of for example ride shares, or the ability to – this is more of not the Ubers per se, but the – I'm trying to remember the name of it, Zipcar; there you go. Those are the ones we use in DC. Where consumers don't feel the need to own a depreciating asset, especially one that loses half of its value when it walks off the lot, drives off the lot, but rather they have access to an asset. That is enough. That's going go to shift the way community financial institutions serve their consumers.

The next example will show you this isn't just about cars and things like that, but the next slide will show you that this is really exemplified by music. This is a huge trend that we've seen over time. The classic example here that it really has affected the way we consume what use to be something that you went out and you purchased: a CD, a record, a cassette tape. It affects the artists as well. It's not just the consumers that are affected, but the creators of a good also are finding different ways of reaching the market.

These two dynamics, the rise of a generation of consumers that have a lot of student loan debt with a shift in attitude saying, I don't need to own things; I can just access them, has given rise to a third dynamic. On the next slide, we'll see some statistics about what we call the gig economy. The rise of the gig economy is nothing new. This is a report from 2014 that says there are 53 million Americans, that's over a third of the workforce, that are working as freelancers.

What is the definition of a gig economy? It's a labor market characterized by the prevalence of short-term contract or freelance work instead of permanent jobs. This is where I want to spend the rest – the bulk of the presentation here because it's really going to – we're going to talk about the implications for financial institutions when they're facing a different dynamic. We have those who want to participate in this economy by choice. Then there are those who are participating in a gig economy because of necessity. We're going to talk a little bit about those statistics.

On the next slide, you'll see here the different types of work. You'll notice on the right-hand side, the smallest portion of the gig economy is those that are providing driving and delivery services although those are the ones that get most of the headlines. That would be your Uber or Lift drivers. One the left side though, you see that 60% of gig economy workers are providing professional, creative, or administrative services.

You'll notice these numbers add up to more than 100 and that's because many people do more than one type of work. That's why the numbers add up. The middle bucket is those for things like home health care or even manual labor. There's a lot of different types of consumers out there that are participating in this. It's important that we understand what percent of our consumers that we're trying to serve might be participating in this.

On the next slide, you'll see that the market is growing really fast. Now, it's a little bit hard to track although the Census Bureau is trying to capture some of this data. They did a new data collection in 2017 that they've only released partial information on, so we don't have complete transparency into the size of the market. There's two things happening on this slide here. The blue on the bottom is the rise of the labor platform. That's where consumers or adults are making money by doing part-time work for another organization.

The green portion of the graph which has grown even faster are looking at capital platforms. That's where a consumer might rent out an asset that they own. For example, their house on Airbnb, or their car, they lend it to somebody else to drive when they're not using it. There's two different ways that people are participating in what some call this gig economy. That is again the labor side as well as the capital side. When you look at this holistically, there is a large portion of our membership that may need a different way of dealing with their financial institution.

Let's do a little bit of a poll here before I go to – if we could switch to the next slide before we go with some data. I want to gauge your perception of the percent of people participating in the workforce – in the gig economy that are doing so by choice. What we're asking here is of those 100% of the people that participate in the gig economy, the 53 million statistic that we looked at, how many do you think are doing so by choice versus necessity? Nathan's going to go ahead and calculate the poll for us. Alright, this may be a statistical way that we run the poll. Most of you picked the middle bucket; we went right for the middle. Let’s go to the next slide and take a look at the actual data because I think you're going to be really surprised.

This study by McKinsey & Company showed that 70% of the people participating in the gig economy are doing so by choice. What we've heard about this is a reaction to not being able to find full-time employment, we find that the data actually shows otherwise. On this grid, you can see the people above the line are the people who are saying they participate in this economy as their preferred choice. A full 30% of gig economy workers do so as free agents. That means they're doing this as their primary source of income. Whereas, another 40% are doing it to supplement presumably a full-time job that they already have.

Below the line are those people participating in a gig economy out of necessity. The reluctants, those people who can't find full-time work and this is their only source of income. Those who may have full-time work or at least a steady employment somewhere whether it's full time or not but are financially strapped. You can see there that 30% are doing it – only 30% are doing it out of necessity.

One final data point if we go to the next slide that I wanted to highlight is that you may also have assumptions about who participates in the gig economy. That is that you’re assuming it's the younger generation, but you see here that seniors are also disproportionately participating in independent work. Now, this might be a real positive. Maybe 60 is the new 40, and when people move into retirement, they want to stay engaged, and active, and so they take on additional work that they can provide their expertise on in a part-time basis. This is probably a good trend to be seeing rather than what many tend to think of as a negative that they can't find part-time work.

On the next slide, we want to talk about the pros and the cons of this and why it matters to financial institutions that are trying to attract their next generation of banking relationships. Part of it is challenging the assumptions that you're thinking about these account holders. If you view all Uber drivers as slackers who can't find a full-time job rather than those who are choosing this opportunity and may have a sustainable source of income, then you lose opportunities here. On the next slide, you'll see the pros. This is how people above the line, those who are actively choosing to participate in the gig economy, think about their choices: they have flexibility and control over their work choice. They are able to move and live wherever they want. That may be a permanent relocation or just day to day. You want to go to a coffee shop today and different coffee shop tomorrow.

For many, it's not their primary source of income; it's an additional source of income. They can leverage a talent, or a hobby, or an asset that they've inherited or purchased to create additional income. It can also really fuel your passion. If you're bored at your full time job, but you have as I mentioned earlier a hobby or something that you really want to do, gig economy workers find this is a great outlet for doing it.

On the next slide though, you would see how maybe the people below the line are thinking about the gig economy. There's a real lack of security. You don't know where your next paycheck is coming from and you don't know how big it's going to be. There's both a timing and a volume problem. There's no benefits. You have to manage your own health care, your retirement, your insurance, everything.

Income volatility is a real problem and that's a real also opportunity for financial institutions to address. Then often, they have to make their own personal investment before they're able to earn income. Classic example there would be Uber drivers, or if you're a creative person, you may have to purchase your own computer, the software necessary to do the work, things like that. You make an upfront investment without knowing whether or not you're going to be able to recoup that income.

Let's go to the next slide. We've discussed three dynamics here. The first was that college financing is delaying financial decisions. The second is the shift away from ownership towards access. Then third, how that really has fueled the rise of the gig economy and making for some – a real different way that we think about finances today. That's where I think the real opportunity is. If we could go to the next slide.

You may think that this is not different than in the past. We still have to produce – we still have to offer auto loans or mortgage loans. In reality, we have to change the way we do those things to appeal to consumers that have a very different conception of money than the old-fashioned traditional, I'm working at a full-time job. I'm going to have a pension or at least a 401(k) at the end of 30 years working in the workforce. One specific threat that I might also add to this life for particularly SEG-based credit unions would be those that – because consumers no longer have that tight relationship with an employer, there's not the HR office that you can walk into to develop the relationships and attract your next generation of members. In many community financial institutions, not just credit unions but banks, also have those types of relationships in the community. When you don't have full-time employees that you can attract, it's difficult to find your next generation.

The question would become, how fast and when do you respond to these changes? How do you respond to these changes? From here, I want to give examples of how some, loosely we would call banking institutions, some of these are bankings, not all of them are bank or credit union charters, are responding to this. How fast the community institutions respond may determine our success moving forward. Now, I have to stress that I think community-based financial institutions are the best ones to solve this dilemma because the traditional underwriting models where you just run everything through an automated decision engine aren't going to work in this environment.

On the next example, these are how some companies are responding. The first example here is Xchange Leasing. This is actually a leasing company that Uber purchased so that their drivers could get access to vehicles. Why is this important to credit unions? First, have you ever talked to your Uber driver and asked if they used Xchange Leasing? Not very many have and those that have recognized that it is a terrible deal.

Today, auto loans count for over a third of our consumer portfolio. There's a real opportunity to understand how we might be able to serve people who need to make purchases upfront before they have a source of income. What does that mean for our underwriting models? Another thing though that credit unions need to be very aware – banks and credit unions need to be very aware of is that you may be making auto loans that you think are just for normal consumer usage. In reality, they're getting a lot more miles put on them from the day they drive off the lot because they're being used as commercial vehicles. If a vehicle has been driven for eight hours a day, that's going to really affect its resale value and your ability to recoup your asset if there is a problem in paying back the loan. It's especially a problem when auto loans have extended out to a 72 or 84-

month payback period when these cars may not last that long if they're really being driven in a commercial capacity.

Another example on the next slide for those above the line is the need for additional financial savviness I would say. When you're a freelancer, you have to think differently about how you plan for the things that may be part of the traditional employment package with your company. You have to save for your own taxes. You have to pay your own part of social security. You may not have insurance or other opportunities that a full-time employer would offer. Here you can see that Fidelity, a very large financial services player is already targeting specifically people who are working in this environment.

The second example on the next slide of another very large financial institution is Goldman Sachs which two years ago purchased HonestDollar. This is a FinTech example. HonestDollar found a way to allow consumers very quickly to make small dollar deposits into savings and retirement accounts. Rather than needing $1,000 to open an account, you could start with very low balances and start to build your savings. This is a technology solution to a challenge, but it's not the main point; the technology enabled the ability to serve consumers who may not have been thinking about how to save for this in the future.

The next slide talks about another opportunity and that is Even. This is a second FinTech example. I mentioned that sometimes technology is a solution to the challenges that we're facing. Even is one that was built specifically for people who may have variable income and they need to think about how they can budget effectively for the highs and the lows. It takes a look at your income over time, and averages it out, and tells much you have safe to spend, and when you have more income than usual, how can you save it.

They've actually moved into a new area now called InstaPay. They have some big partnerships, for example, with Walmart where a contract worker doesn't have to wait a week or two weeks for pay, they can ask to get paid for the work they have already done on a daily basis. This prevents people from having to go to a payday lender to make it to the next payday cycle. It also makes it more difficult I would think for the employers themselves to manage cash flow when you've got employees who want to be paid on a daily basis. It's a give and take. How do we adapt as an institution, as employers our practices, while also serving the members that need it?

The next slide talks about what I would view as both an opportunity and a challenge. That is how do you change your underwriting practices to account for the unevenness in income? You can see from this slide here that was part of the U.S Financial Diaries that the typical gig economy worker has five spikes or dips in a year. You can see that's defined as 25% above or 25% below the average income. You may be leaving loans on the table if we haven't figured out how to adjust our automated underwriting models because people can make a very good living in the gig economy. It just may not come in the traditional your entire income divided by 26 paycheck model that we are used to thinking about. This is why community financial institutions I think are best suited for this new economy because it's going to take face to face conversations to really understand where people are good bets that we may be leaving money on the table rather than just dismissing people who don't fit our traditional models out of hand.

The next slide talks about another area that you can use in designing product features. Again, this isn't technology; this is just a product feature. The classic example is skip a pay. If people have that variable income that we just discussed, giving them the opportunity to skip one monthly payment when they know they're going to have a big contract coming up the next would be a great way for community financial institutions to help people manage the variability of their income.

The final point I'd like to make on the last slide is that most contract workers are, especially those that are doing it by choice, don't necessarily have an office. In fact, of course, Uber drivers and those others are always on the go, but you may be visiting different client sites, moving around. Banking institutions really need to focus on a mobile-first strategy. That doesn't mean that you create a responsive website that looks good on a mobile device, but rather, you start with a mobile application, so that is – you optimize the experience for that, so that these consumers that are on the go have the opportunity to engage with you in the most attractive way for them.

To sum it up, what I really wanted to talk about was the future, and how you're attracting the next generation, and how we tend to focus on technology. I'm suggesting there's a lot of opportunity if we understand the financial hardships and the dynamic that's changing how consumers think about their finances, their sources of income, and things that we can do to understand better what it is in our account holders – where the opportunity might lie to grow in the future. With that, I'll turn it back over to you, Sheila.

Sheila: Awesome, Alix. What valuable and fascinating information you've provided for us today. Just want to remind everyone that you do have the option to submit questions. They will remain anonymous. If you want to go ahead and do that now, we'll begin taking questions. I already have one, Alix, actually that has come in. Let's go ahead and ask that one: how do we go about accessing how many of our account holders are participating in the gig economy? Great question.

Alix: That is a good question. When working with our clients, there's a couple of ways that they're going about doing this. The first is looking at your data. It's really a data mining question. Can you see where income may be coming from? For example, payment from online capital platforms like an Etsy, or an eBay, things like that may indicate people are participating in the gig economy on the capital side.

Also, if you've got consumers that have direct deposit, but it's variable, that tells you that there's a good indication that it's not a full-time employment but part-time employment. Some of it's asking the questions. Are there ways that we can engage our membership to find out literally by asking how many are participating in this. We talked to one SEG-based credit union that found 20% of their membership was participating in other sources of income which was really surprising because they were SEG-based. They assumed all of their members had a full-time job with their employer and that wasn't necessarily the case. I'd say it's a data challenge. Start there and start looking for patterns, and building off that to say, how can we design product and services that would serve these consumers?

Sheila: Fantastic; let's give it a few seconds for others to submit questions. Okay, I've got one that's come in. It says: please explain how supplemental income is viewed as want to versus need to. Let's see, it says: if you're working a full-time job – sorry, I need to adjust my screen here to see the whole question. If you're working a full-time job – I'm so sorry, Alix. Just a moment, I'm having a technical difficulty here.

Alix: No worries.

Sheila: – if you're working a full-time job and take on extra work it's not for a hobby? Great question. Alix, let me know if you'd like me to read that again since I had to stop in the middle.

Alix: Yeah, could you please? I don't think I got the full question.

Sheila: Sure: please explain how supplemental income is viewed as want to versus need to if you're working a full-time job and take on extra work it's not for a hobby.

Alix: Okay, I think you're referring to the McKinsey study that showed that some people do it out of necessity and some do it out of desire. I think it's a mindset. That's what they were trying to uncover in that study was saying there are a percentage of people who have a full-time job, but they're also doing something that involves supplemental income. It's a mindset: are you doing it because you want to or because you have to?

You have to meet a certain – you've got bills that you can't pay unless you do this, or you can't save for retirement, or even things like travel. Maybe that you can meet all your obligations, but you're not able to do the things that make you happy. In that study – and I think that's what you're referring to here. I'm hoping I'm answering the question correctly. That was a mindset question. They were trying to – I don't know the exact question they asked to get to that, but that's how they distinguished between the two groups: those that had to do it and those that didn't have to that still had a full time job.

Sheila: Excellent question, and Alix, as usual, a great clarification. Okay, let's see. Okay, I have another question: going back to the ownership versus access slides, what impact do you see that having on community-based financial institutions?

Alix: I think the first one is to really evaluate your auto loan portfolio. I'd start there. For many, auto loans are a large piece of the pie. The rise of this philosophy that we don't need to own an asset; we can share an asset, is going to change the way consumers purchase or think about purchasing cars.

I'm not saying that cars are coming off the road, but it may be that there's, for example, fleet ownership. That you're going to want to rent cars more often than purchase cars. Community-based financial institutions need to figure out how do you lend to fleet lenders instead of – maybe that's a fleet of 10 or 15 in small communities; maybe it's bigger. It could really disrupt the way one to one lending occurs.

I also think consumers are going to be interested in spending money on things that don't necessarily have a hard asset that you can reprocess. You see today that consumers talk about they'd rather spend money on travel than on owning a house. They may still want to borrow to do that and pay it back over time, but you don't have an asset that you can lend against. That changes the way you think about how you serve consumers. Now, many people may just put it on a credit card, but that's the most expensive form of debt.

You can't encourage people to go out and put a $10,000 safari on a credit card when there might be a more consumer-friendly way to recognize that's a choice they're making. That that choice isn't any better or worse than saying you're going to buy a $10,000 car; it is an asset that depreciates quickly. We have to change our mindset about I'm not judging someone who wants to take a vacation of that's the choice they've made, and they can pay back the loan over time; it's just a different model. Where before, we always said, well, as long as there's an asset I can reprocess, that's a good one that we can make. I'm saying of course of credit, underwriting, and all of that; I don't mean just lending, but you make a choice to make a loan just because you can reprocess an asset.

Sheila: Excellent, thank you, Alix. I may need a little bit of clarification on this next question, but this individual is asking for examples of best products or best practices to serve this new economy. Thank you for the additional insight for the question asker.

Alix: Yeah, I think that's a really good one. We didn't have time to go into really detailed examples today of those. We have some case studies on our website, creditunions.com, of how credit unions in particular are serving this market. I would go back to the one slide that talked about designing ways for consumers to manage their cash flow on loan products: skip a pay, things like that. Those were traditionally aimed at teachers who may not have income spread out throughout the year. There's a lot of people who might think about adding those types of products in a very consumer friendly way that could change the dynamic for those with variable income.

Also designing financial education and literacy programs I think is really critical. Having one on one financial counseling to work through budget challenges. It's a much more – and this is why I said I think community-based institutions are so much better suited to this than large ones because it takes a lot more face to face relationship building in order to develop those relationships and identify how can you help the consumers. Everyone is different, and they're all going to have different needs, and different patterns of income and outflows. Understanding how to have the conversations one on one is going to be critical and then figuring out ways to scale from that.

Sheila: Excellent, extremely valuable. Alix, let me keep the question block open for another 15, 20 seconds if anyone has any other questions they'd like to ask. Okay, I'm not seeing anything else come through. Just a few more seconds.

Okay, well, Alix, we really appreciate your time and knowledge today and your expertise. It looks like we don't have any other questions, so I am more than happy to give back 25 minutes of everyone's time today. As a follow-up to today's program, you can expect an email from Harland Clarke with links to a recording and a transcript of the presentation. Please feel free to share the recording with any of your colleagues who may have missed today's session. Join us on December 5th for our next *Informed Banker* presentation, "Economic Outlook for Community Financial Institutions." This will be presented by Jordan van Rijn, a Senior Economist for the Credit Union National Association.

Alix, thank you so much again for being with us and sharing your knowledge with us today. I'd like to extend a very sincere thank you to you and the many financial services professionals who made the time in their busy schedules to be with us today. I hope to see you all again at future *Informed Banker* sessions. That concludes today's session. Thank you for joining us this afternoon.