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SFA Research Corner

Consumers Turn to Credit Unions—Credit Unions Turn to Securitization

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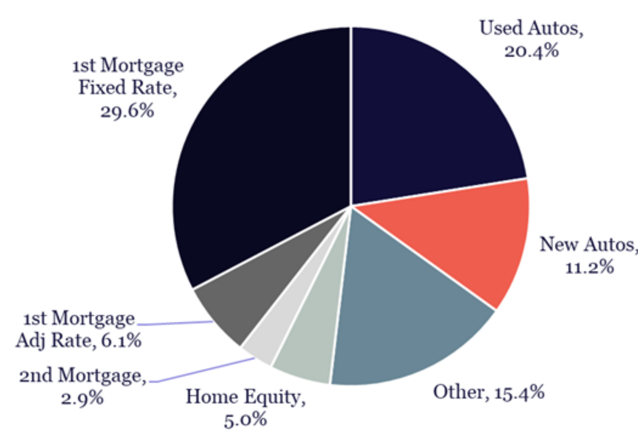
On September 26, Ent Credit Union, a federally insured state-chartered credit union (FISCU) in Colorado, made its debut in the securitization markets by launching a $243 million auto loan asset-backed securities (ABS) offering. This inaugural transaction is supported by prime auto loans primarily originated by Ent within the state of Colorado. It represents the sixth auto ABS offering this year by a credit union and only the tenth such offering since credit unions entered the auto ABS market in 2019. With this latest issuance, credit unions have successfully raised more than $2.5 billion by issuing securities backed by auto loans. Notably, auto loans constitute a significant portion, 31% or roughly $500 billion, of the $1.6 trillion in consumer loans held by credit unions.

The securitization of credit union assets became possible thanks to a 2017 opinion by the National Credit Union Administration (NCUA), the federal agency responsible for regulating federally chartered credit unions. The NCUA affirmed the authority of federal credit unions (FCUs) to issue and market securities as a standard part of their operations. In this pronouncement[1] the NCUA highlighted the advantages of securitization for federal credit unions, including its role as "a significant source of liquidity to enhance lending activities" and its capacity to offer federal credit unions "greater flexibility in the face of heightened loan demand or increased competition for deposits." Additionally, securitization would enable federal credit unions to become "less reliant on share deposits" while also "mitigating a substantial portion of credit risk by transferring it to investors."

Distribution of Credit Union Loans
$1.6 billion as of July 2023



Source: Credit Union National Association

Subsequent guidance was provided by the NCUA in February 2019, offering further clarification regarding the bankruptcy-remote treatment of financial assets from credit unions involved in securitization. Only six months later, a significant milestone was achieved in the credit union sector when GTE Financial (previously GTE Federal Credit Union) completed its inaugural transaction, issuing $147 million in prime auto asset-backed securities (ABS).

The largest transaction to date has been the $460 million PNFD 2022-A, a fixed-rate, amortizing note backed by prime auto loans. The transaction was issued by Pentagon Federal Credit Union (PenFed), the third largest FICU in the nation with 2.9 million members and $35.5 billion in assets. PenFed also holds the second-largest consumer loan portfolio among all credit unions, encompassing auto, personal, student and consumer loans, and credit cards. In its announcement of the transaction, PenFed provided three primary reasons for opting to securitize these loans: to hedge against interest

[1] The NCUA 2017 opinion only applies to FCUs as state law determines authorization for such activities for state-chartered credit unions.

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rate risk, bolster liquidity, and strengthen its net worth. One year later, in a subsequent press release, PenFed reiterated its commitment to utilizing securitization as a strategic tool for further diversifying its liquidity and funding options. This decision was reinforced by positive performance results, which led to upgrades in the ratings of three asset-backed securities (ABS) classes.

Credit unions are member-owned nonprofit cooperatives that provide a wide range of financial services to their members, offering competitive interest rates compared to banks. Additionally, members receive "dividends" on their "shares," which are equivalent to deposits. These shares serve as the primary source of funding for the credit union's lending and investment activities. U.S. credit unions have the same dual system that banks have—charters can be issued by either federal or state governments. States supervise their state-chartered credit unions. At the federal level, the National Credit Union Administration (NCUA) provides insurance on credit union shares (member deposits), regulates federally-chartered credit unions (FCUs) and, to a lesser extent, regulates all federally insured credit unions (FICUs) including those that are state-chartered. Almost all state credit unions' shares are federally insured.

Credit Union ABS Issuance 2019-2023

Issuing Credit Union	Assets ($ BN)	Transaction	Issue Amt ($ MM)	Issue Date
GTE Financial	$2.9	GART 2019-1	$147	Nov-19
Unify Financial Federal Credit Union	$4.1	UART 2021-1	$300	Mar-21
Pentagon Federal Credit Union (PenFed)	$35.5	PNFED 2022-A	$460	Aug-22
Oregon Community Credit Union	$3.5	OCCU 2022-1	$275	Oct-22
GTE Financial	$2.9	GTE 2023-1	$203	Apr-23
Veridian Credit Union	$5.0	VCU 2023-1	$290	May-23
General Electric Credit Union	$5.0	GECU 2023-1	$300	Aug-23
Oregon Community Credit Union	$3.5	OCCU 2023-1	$258	Sep-23
ENT Credit Union of Colorado	$9.9	ENT 2023-1	$243	Sep-23

Source: Finsight

As of the second quarter of 2023, total outstanding loans had reached $1.56 trillion, representing a year-over-year growth of 12.6%, well above the historical annual growth average of 8% and remarkable on its own, but made more so after 2022—an exceptionally robust year for loan growth, with credit unions experiencing a record-breaking 19% increase in loans. Large credit unions, those with assets exceeding $500 million, reported an even more impressive 20% increase in loan growth during this period.

Credit Unions' Loan Growth YOY by Loan Type

	2018	2019	2020	2021	2022	2023 (6mo)
Credit Card	8%	7%	-6%	4%	16%	14%
Payday Alternative	23%	21%	6%	24%	42%	24%
Student	17%	7%	9%	10%	14%	3%
Other Unsecured	7%	8%	13%	-2%	23%	16%
New Vehicle	11%	0%	-4%	0%	22%	13%
Used Vehicle	9%	4%	5%	10%	19%	10%
Lease	17%	13%	1%	16%	23%	11%
Other Secured NRE	10%	8%	10%	17%	18%	12%
First Lien RE	8%	8%	9%	9%	17%	9%
Junior Lien RE	19%	4%	-8%	-1%	39%	34%
All Other RE	-68%	-26%	-12%	-8%	-16%	2%
Commercial RE	16%	17%	16%	19%	25%	18%
Commercial NRE	-10%	3%	5%	10%	22%	14%

Source: National Credit Union Administration

While robust loan growth can lead to increased net income for credit unions, it may also place pressure on funding sources, distort the balance sheet, and, especially in the current environment of rising interest rates, pose liquidity challenges. In the past, high loan demand has been managed by either slowing down lending or by engaging in loan participation agreements. However, as industry leaders recently pointed out at the first-ever capital markets symposium for credit unions, the rising cost of deposits is currently hindering these loan participations[2] . This has prompted credit unions to consider securitization as part of their risk management discussions, particularly as they now hold more consumer credit than ever before.

In addition to risk mitigation, by turning to securitization credit unions are also finding more funding to meet growing consumer demand. This, in turn, is drawing investor interest. According to Citi Research, 2023 credit union auto ABS are backed by high credit quality loans (average FICO scores between 730-743) and are expected to have cumulative losses of less than 1%--factors that support investor demand. Given these positive drivers of supply, Citi Research expects more offerings from credit union auto ABS going forward.

[2]Loan participation at a credit union refers to a collaborative lending arrangement in which a credit union partners with other credit unions or financial institutions to share the risk and benefits of a particular loan or a pool of loans.