Do CUSOs Really Make a Difference?

A White Paper by the National Association of Credit Union Service Organizations (NACUSO)

April 2020

Do CUSOs Really Make a Difference?

Contributors:

NACUSO:	Jack Antonini, President Guy Messick, General Counsel
Callahan & Associates:	Jay Johnson, Chief Collaboration Officer and President, Callahan Financial Services Sam Taft, AVP Analytics and Business Development
CU*Answers:	Jim Vilker, VP of Professional Services – Audit Link Bob Frizzle, CFO

A Significant Difference

The short answer is yes and the difference for credit unions can be significant. There is a lot of anecdotal evidence from credit unions that their use of CUSOs has helped them improve their services to their members, often at lower costs. Few credit unions empirically measure the financial performance difference a CUSO makes so it is easy for some credit unions to discount the advantages of using CUSOs.

Jay Johnson, President of Callahan Financial Services and a NACUSO Director, and I (Guy Messick) have been searching for a way to measure the CUSO advantage through industry statistics. Can we use industry data to determine whether the use of CUSOs by credit unions correlates to better financial performance as compared to credit unions that do not use CUSOs?

Credit Unions Analyzed

We wanted to find a group of credit unions that use CUSOs extensively and compare their performance to credit unions that do not use CUSOs at all or not as extensively. For the CUSO users, we turned to the credit unions using CU*Answers. CU*Answers, Inc. was formed in 1970 as a core IT provider. It is structured as a cooperative corporation. There are 136 credit union owners serving 183 credit unions.

Xtend, Inc. is an affiliate CUSO that is owned by CU*Answers and 80 credit unions. Xtend provides services to credit unions that include bookkeeping, mortgage loan support, disaster recovery, business continuity, strategic planning, call center (both incoming and outgoing), shared branching, forms exchange, member texting communications, core conversion support, call report preparation, and cooperative liquidity through loan participations and certificate of deposit sales.

AuditLink, a division of CU*Answers, provides shared execution services including vendor management and daily evaluation of high-risk transactional activity. While some credit union owner/customers are over a billion dollars in assets, most customers are small and mid-sized credit unions, the very size that should derive the most benefit from collaboration.

CU*Answers pays dividends to the owners. As a Michigan cooperative, CU*Answers pays a stock dividend each year (averaging between 4% and 8% of the investment for each credit union). There is a patronage dividend which is proportionate to the amount of business a credit union does with the CUSO. If CU*Answers has a special project and needs capital, it will issue debentures which have a return slightly above market. The debentures are often over-subscribed.

The control groups consist of credit unions that are the same asset size as the CU*Answers groups and do not have a CUSO investment. While the available data does not indicate how many CUSOs a credit union may use for services, it is possible to see from the NCUA call reports whether a credit union has a CUSO investment. If a credit union does not have any CUSO investment, the credit union will not have any benefits deriving from CUSO ownership and it is more likely than not that the credit union does not use CUSOs extensively as service providers.

Results

Jay Johnson and Sam Taft at Callahan identified through industry data the credit unions for the control groups that do not have a CUSO investment. Bob Frizzle and Jim Vilker at CU*Answers assisted with the data at their end.

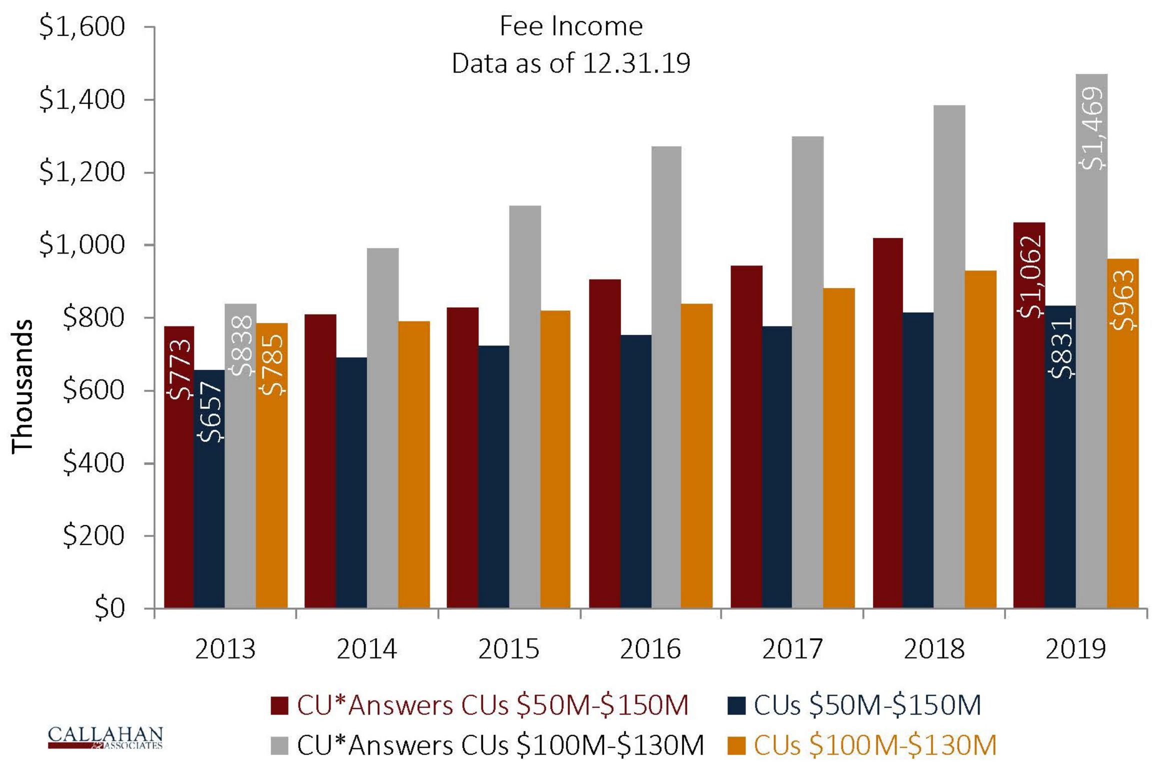
The performance data was measured as of the fourth quarter in years 2013 to 2019 and divided into four cohorts for two peer size comparisons. The first cohort of CU*Answers credit unions between $50 million and $150 million in assets (averaging 52 credit unions per year) measured against the second cohort of credit unions between $50 million and $150 million in assets that do not have a CUSO ownership relationship (averaging 460 credit unions per year). The third cohort of CU*Answers credit unions between $100 million and $130 million in assets (averaging 10 credit unions per year) measured against the fourth cohort of credit unions between $100 million and $130 million in assets that do not have a CUSO ownership relationship (averaging 84 credit unions per year).

Sam Taft at Callahan analyzed the data and prepared the following ten charts which show the performance of the four cohorts for:

- Fee Income
- Other Operating Income
- Share Draft Penetration
- Accounts Per Member
- Average Member Relationship
- Operating Expense Ratio
- Efficiency Ratio (excluding PLL)
- ROA
- Net Worth Growth
- Asset Growth

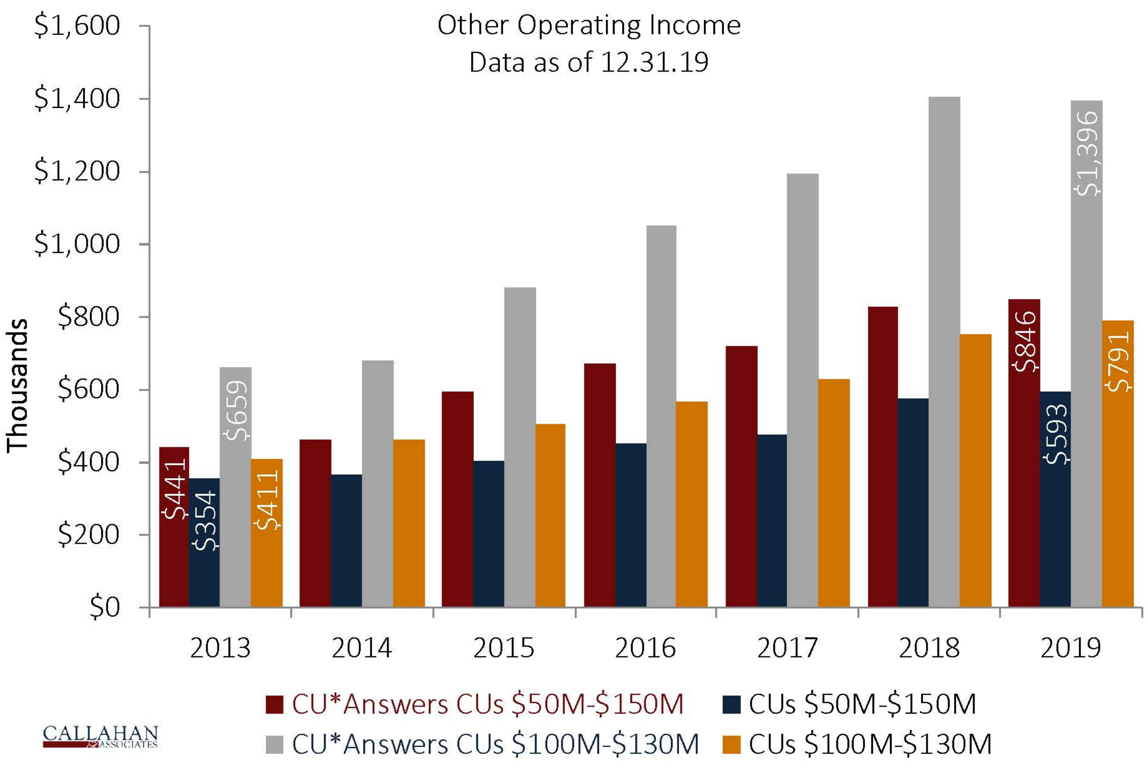
Fee Income

The Fee Income Chart emphasizes the widening gap between the CU*Answers credit unions and the peer groups. Specifically, over the period, fee income for the CU*Answers credit unions expanded 37.3% for the $50M-$150M range, and 75.4% for the $100M-$130M range – compared to 26.5% and 22.6% for the asset-based peer groups, respectively.



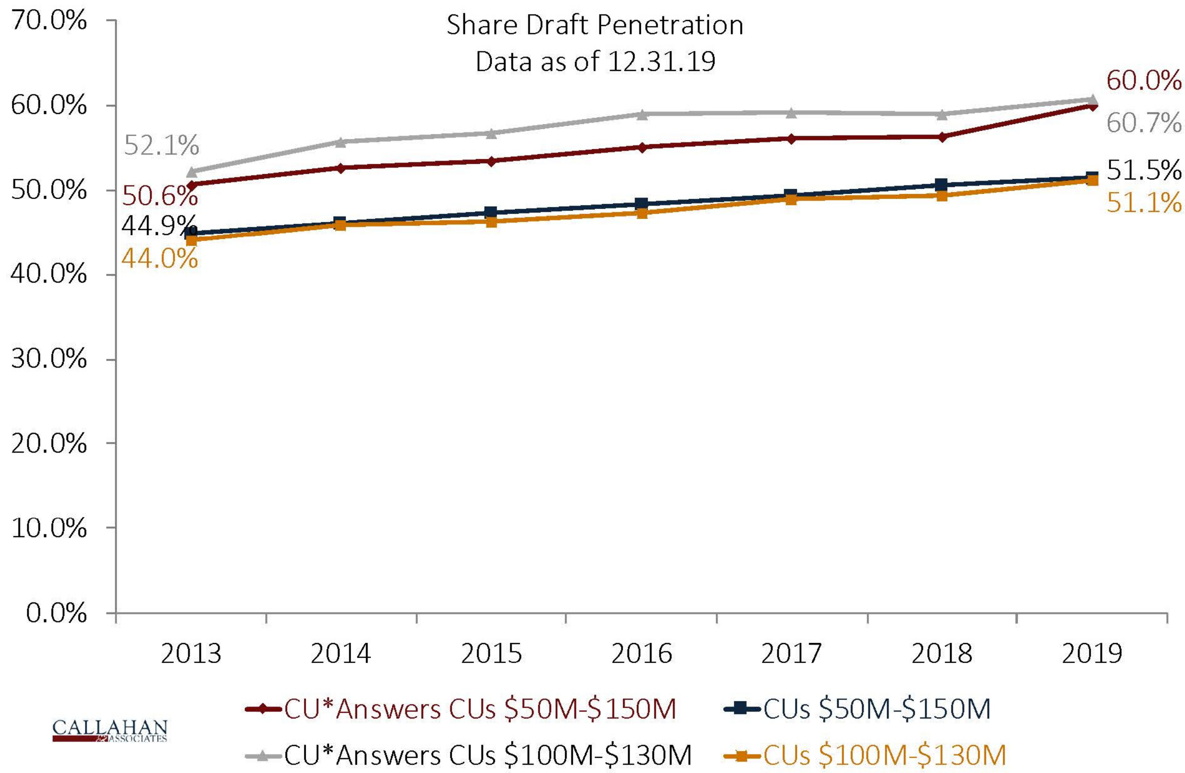
Other Operating Income

In addition to fee income the other primary category of non-interest income is Other Operating Income. Other Operating Income largely contains CUSO revenue (e.g., dividends), secondary market sales, and interchange income. There is a pronounced advantage for both of the CU*Answers cohorts over the control groups, indicating the CU*Answers credit unions are more effectively diversifying their income sources and ultimately, generating higher levels of income.



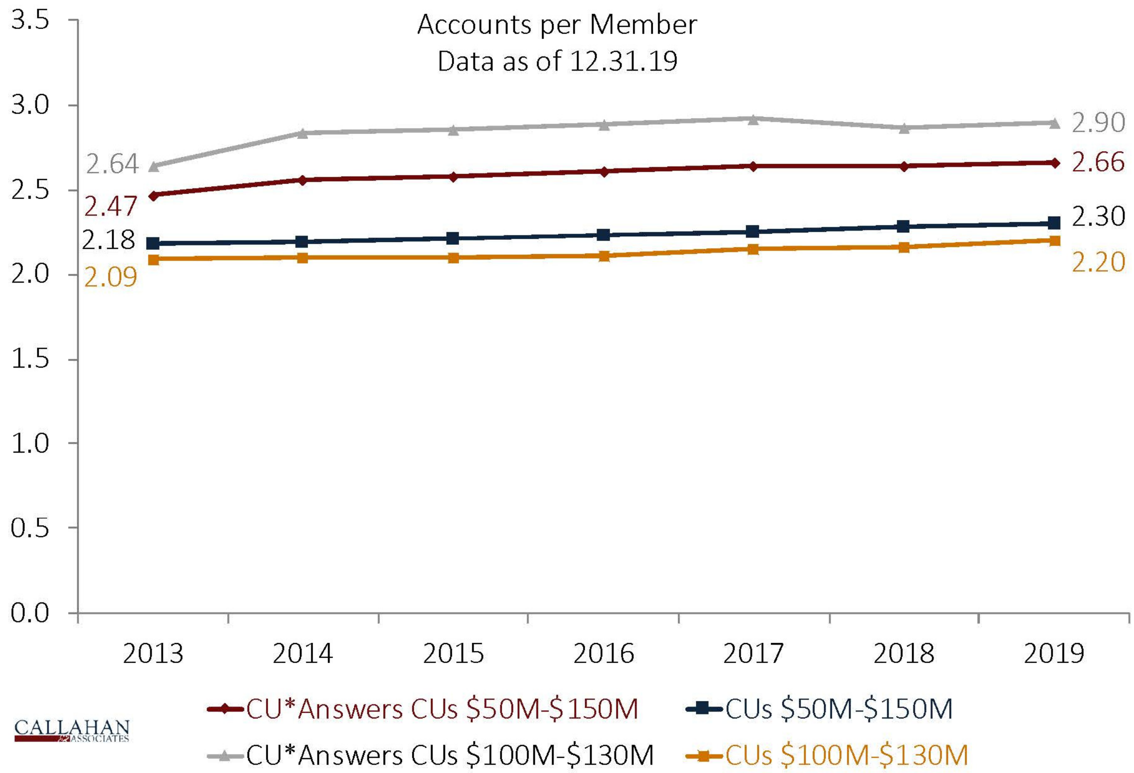
Share Draft Penetration

Higher share draft penetration tends to indicate a greater likelihood members use a credit union as their primary financial institution, and with that you'd expect to see associated benefits, i.e., widening and deepening of member relationships. Both CU*Answers cohorts exceed their peer cohort control groups.



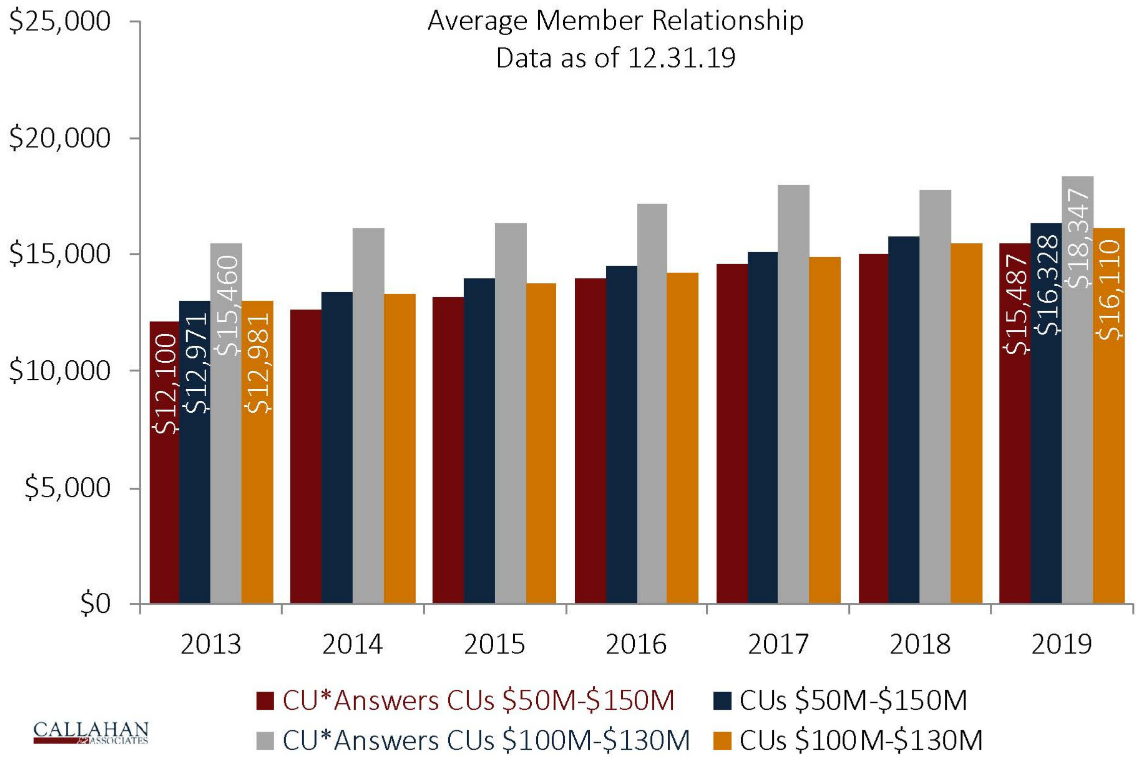
Accounts Per Member

From a member engagement perspective, the trend below is quite validating that credit unions which utilize CUSOs have deeper service relationships with members, quantified by their members utilizing a wider range of products and services.



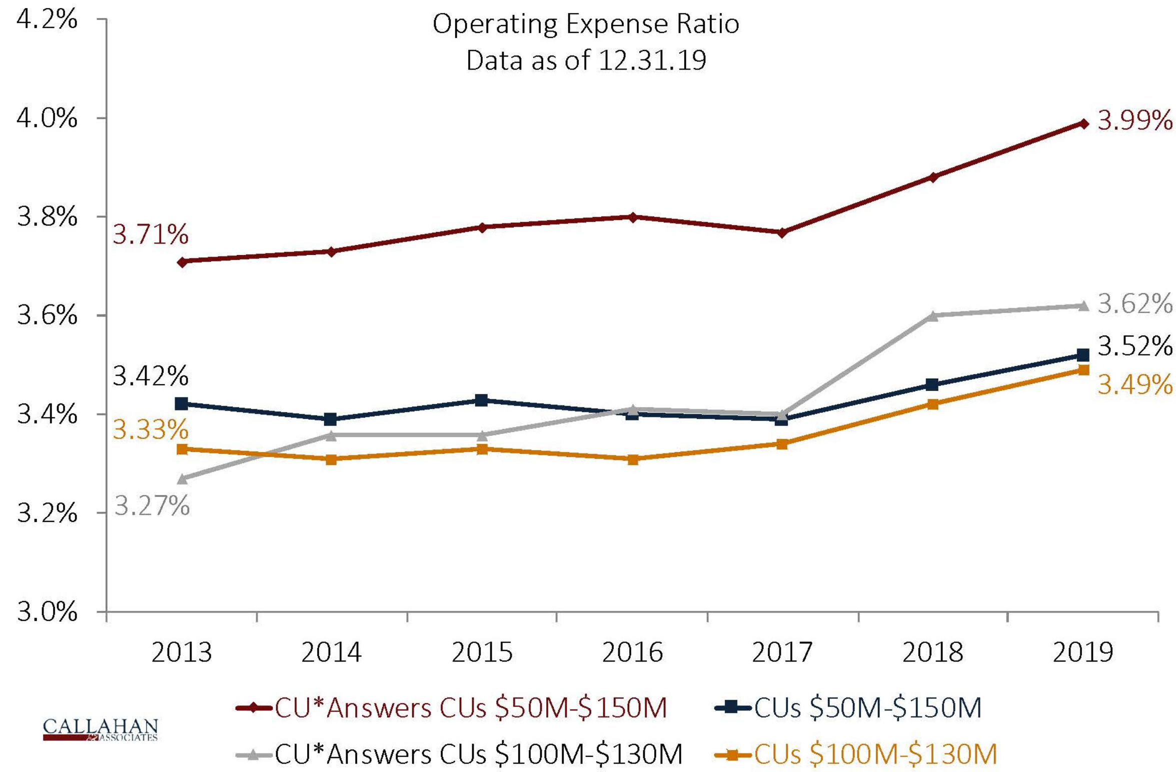
Average Member Relationship

This number is the average retail member relationship (loans plus shares less non-member deposits and commercial loans, divided by total members). The chart shows the CU*Answers cohort in the $100M-$130M peer group has an average member relationship $2,237 above their peers and has maintained a favorable advantage over the period.



Operating Expense Ratio

While the CU*Answers credit unions have higher operating expense ratios, it is important to compare the Operating Expense Ratio with the following Efficiency Ratio Graph.

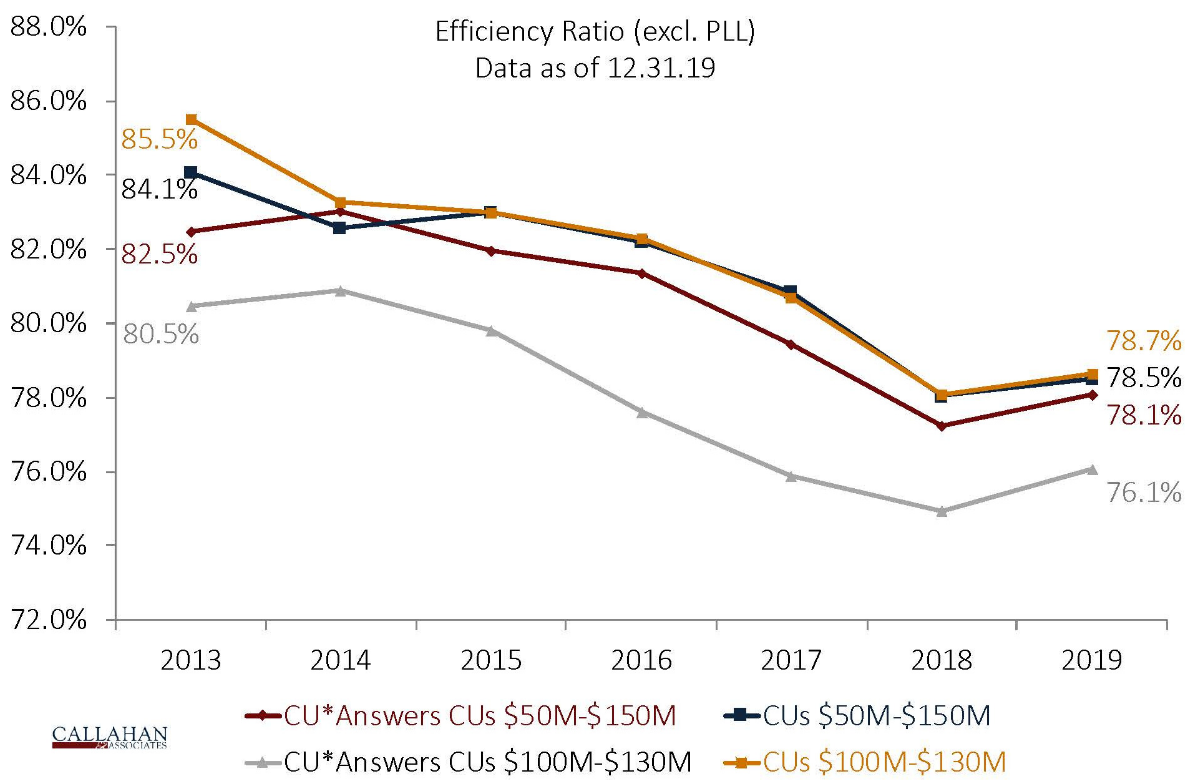


Efficiency Ratio (excl. PLL)

(What a credit union spends to make $1, excluding Provision for Loan Losses):

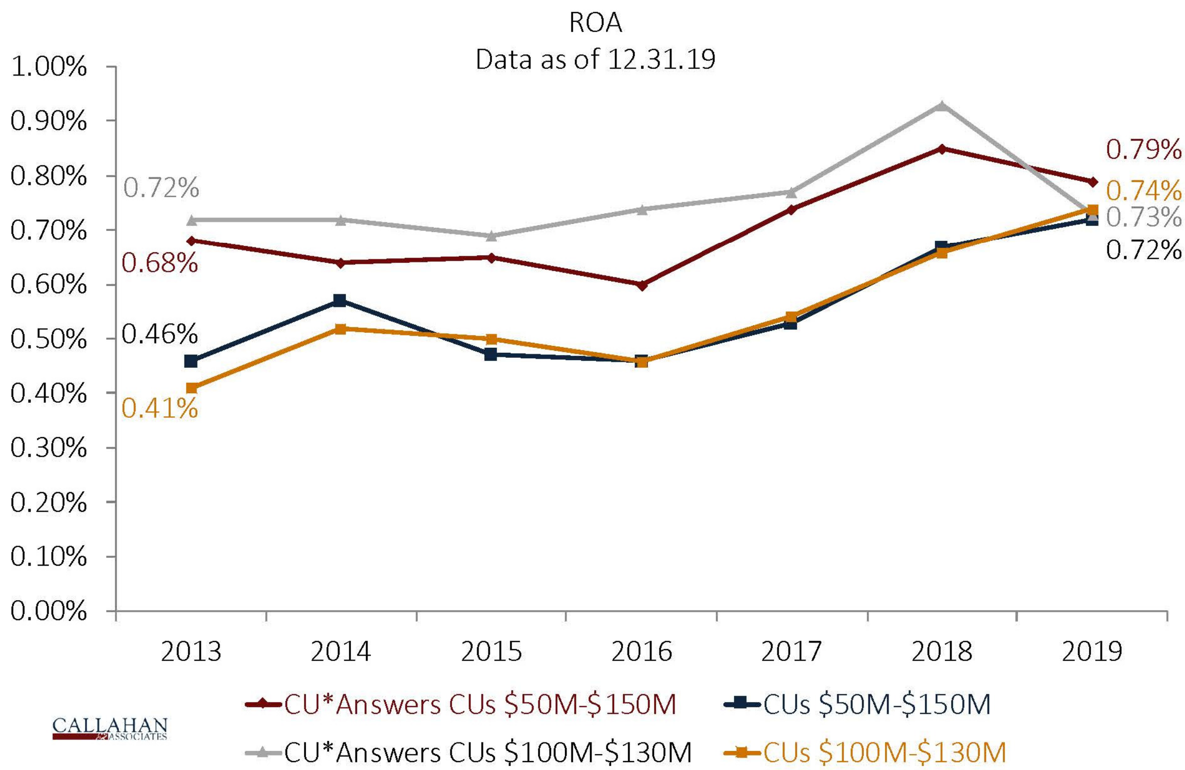
The Efficiency Ratio is a complement to the traditional Operating Expense/Average Assets Ratio, calculated as Operating Expenses divided by Net Interest Income plus Fee and Other Operating Income. Whereas the Operating Expense Ratio provides perspective on Non-Interest Expenses relative to a credit union's asset size, it does not have an income element. Thus, you cannot quantify if a relatively large operating expense base is being effectively leveraged to generate more income.

The Efficiency Ratio highlights that while both of the CU*Answers cohorts report higher than average Operating Expense Ratios compared to the control cohorts, both CU*Answers cohorts reported lower (better) Efficiency Ratios, indicating that the CU*Answers cohorts are proportionally earning more income on each dollar spent.



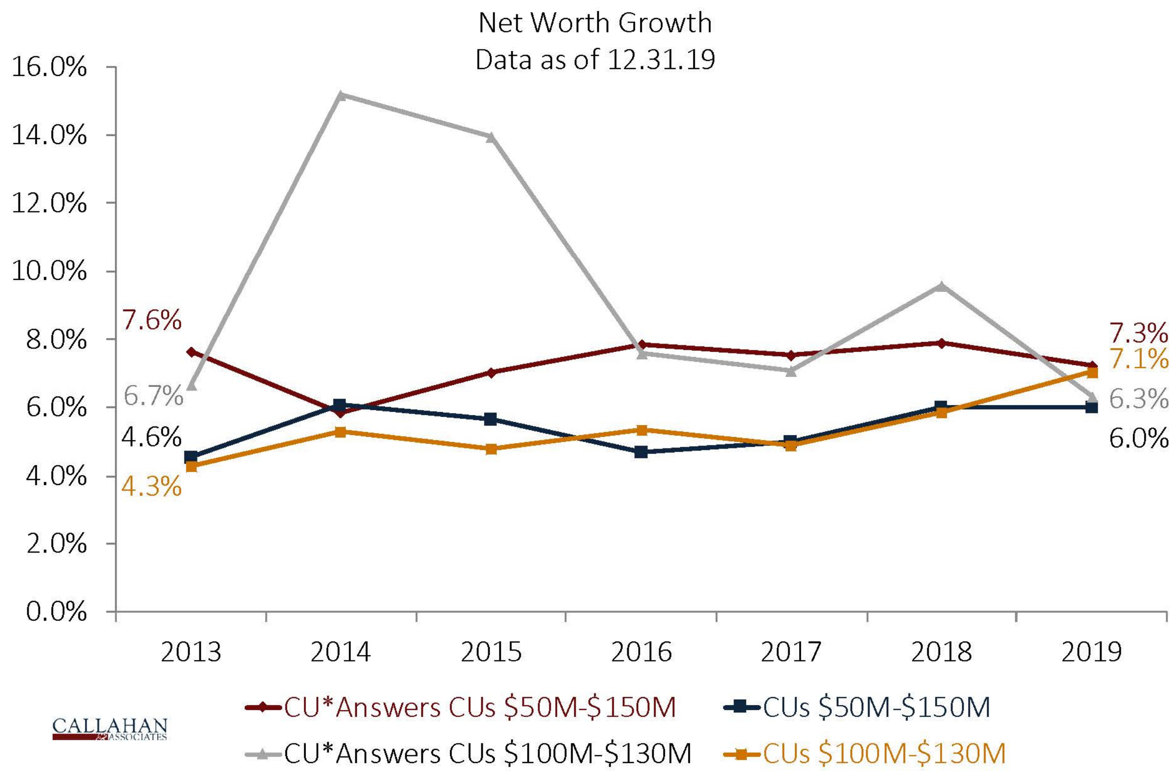
ROA

The first cohort of CU*Answers credit unions in the $50 million to $150 million peer class significantly outperformed the second cohort of credit unions not investing in CUSOs in Return on Assets ("ROA"). The differences in average yearly ROA was 23%. The third cohort of CU*Answers credit unions in the $100 million to $130 million peer class outperformed the fourth cohort of credit unions in ROA by 32%.



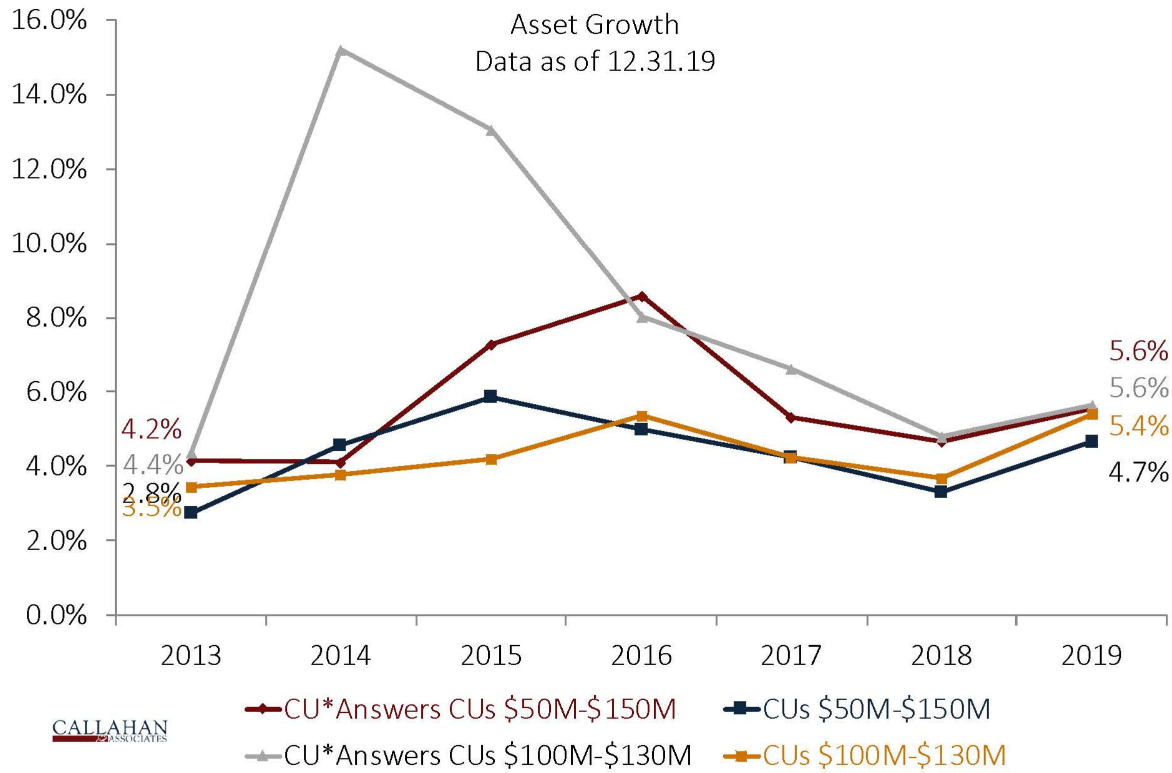
Net Worth Growth

The first cohort of CU*Answers credit unions in the $50 million to $150 million peer class significantly outperformed the second cohort of credit unions not investing in CUSOs in Net Worth Growth. The differences in average Net Worth Growth was 34%. The third cohort of CU*Answers credit unions in the $100 million to $130 million peer class outperformed the fourth cohort of credit unions by 77% in Net Worth Growth.



Asset Growth

The first cohort of CU*Answers credit unions in the $50 million to $150 million peer class significantly outperformed the second cohort of credit unions not investing in CUSOs in by 23% in Asset Growth. The third cohort of CU*Answers credit unions in the $100 million to $130 million peer class outperformed the fourth cohort of credit unions by 91% in Asset Growth.



Analysis

There is no question that the CU*Answers cohorts outperformed the peer group credit unions that do not own CUSOs and likely did not use CUSOs extensively. The industry data supports the anecdotal evidence.

Credit unions that use CUSOs can receive value several ways. Value can be realized in the type, number or quality of loans a CUSO can help credit unions make and service, leading to more interest income. Value may be more fee income generating opportunities in selling alternative financial services such as investments or insurance. Value may be in lowering operational costs. Value may be in being able to afford higher levels of expertise and technology to better serve members and be more competitive against Fintechs. Value may also be realized through dividend payments. This enhanced value enables these credit unions to be high performers and enjoy growth that is significantly higher than their peers.

Which credit unions have the best chance of being long-term survivors? It is those credit unions that are above industry averages in growth metrics. The data shows that credit unions that have elected to use the power of collaboration through CUSO relationships have demonstrated their ability to out-perform other credit unions in their peer group that do not use collaboration through CUSOs.

CU*Answers and Xtend, like many CUSOs, are owned and exclusively controlled by credit unions. It must be remembered that the credit for success of a CUSO does not belong to the CUSO, it belongs to the credit unions that envisioned, formed and operate the CUSO. The CUSO is but the means for credit unions to collaboratively create options and opportunity for themselves and their members. If you had any doubt about using a CUSO, just do it.

NACUSO

3419 Via Lido, PMB #135
Newport Beach, CA 92663
(949) 645-5296
www.nacuso.org
info@nacuso.org