Special Report: CUSOs

Credit Union Management

APRIL 2019

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Credit union service organizations offer economy of scale and the opportunity for new service fee revenue.

PLUS

5 IMAGINE THE POSSIBILITIES
By PSCU

8 ADOPTING NEW LOAN TECH PRODUCES RECORD GROWTH
By CU Direct

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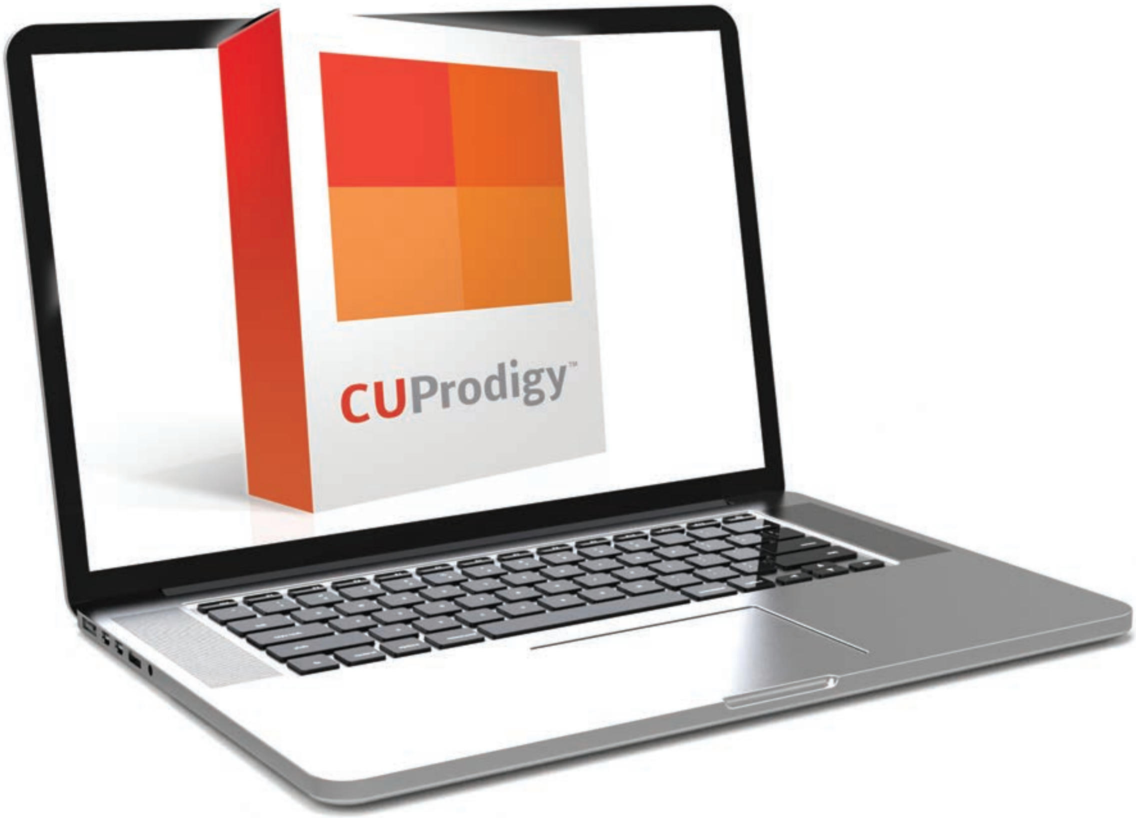

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Using CUSOs to Generate *Net Income*

CREDIT UNION SERVICE ORGANIZATIONS OFFER ECONOMY OF SCALE AND THE OPPORTUNITY FOR NEW SERVICE FEE REVENUE.

BY DANIELLE DYER

Guy Messick, partner with Media, Pennsylvania-based law firm Messick Lauer & Smith P.C. (*cusolaw.com*), opened his 2018 CUES Directors Conference session with a wake-up call: "There is danger out there." If your credit union wants to survive, he said, "it's best to stay alert, engaged and ready to make changes."

Messick has served as general counsel to the National Association of Credit Union Service Organizations (*nacuso.org*) and the liaison with the National Credit Union Administration (*ncua.gov*), for over 30 years. He shared his CUSO expertise with attendees at Directors Conference (*cues.org/dc*), held in December in Waikoloa, Hawaii.

According to statistics published by NCUA, the number of insured CUs is predicted to drop below 4,000 in 2020 after a steady decrease from around 15,000 in the mid-1980s. Between 2013 and December 2018, Messick reported, more than 80 percent of mergers involved CUs in the range of $50 million in assets or lower.

"So size does matter," noted Messick. Without it, CUs can't achieve the economies of scale necessary to stay competitive and meet member needs.

Messick surveyed the room on key member expectations, asking attendees to raise their hands if their CU was currently meeting or exceeding a particular expectation, and if not, to raise their hands if their CU had plans to meet that expectation.

The first expectation received largely positive responses: "I can conduct virtually all my deposit and loan transactions on my mobile device." Most attendees signified that their organizations were currently meeting that expectation or actively working on it. A few attendees were just starting to make plans to meet that expectation.

However, other statements had weaker responses. Some attendees agreed that members expect CUs to make "super quick loan decisions," but just a few hands went up to say they were meeting that expectation today. Only a third said they were meeting members' expectations to provide products and services at competitive costs.

CUs need to accomplish these member expectation objectives while also meeting revenue requirements to survive, said Messick. To start, ask these three questions: (1) Do we need more resources and scale to meet members' expectations? (2) If yes, can we afford to generate those resources on our own? (3) If not, do we merge or collaborate?

If the answer to No. 2 is no, Messick proposes CUSOs as an alternative to merging. CUSOs can offer CUs the opportunity to make more revenue and save on operational costs while also providing access to

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Thinking Big With CUSOs (*cumanagement.com/0418thinkbig*)

Innovating With CUSOs, an Interview With Linda Bodie (*cumanagement.com/podcast19*)

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CUSO ownership today is directly proportional to owner-credit union asset size—the bigger the CU, the more likely it is to have CUSO relationships, said Messick. But working with CUSOs is especially advantageous for smaller CUs. Lending programs are a good example of why such collaboration could be key to growth.

According to Messick, almost 45 percent of multi-owned CUSOs specialize in lending. Mortgages can be a major challenge for small CUs looking to grow their loan portfolios. "The mortgage industry is all about scale and size," Messick said. "If you're not big enough, you can't afford the expertise." By joining forces to form a CUSO, these CUs can achieve the necessary scale together and, with access to lending expertise, diversify their portfolios from such staples as mortgage and auto loans to business lending and beyond.

CUSOs can also assist in driving fee revenue. The fee income, such as from overdrafts, that many CUs relied on in the past has been cut back by regulation in recent years. However, Messick noted that ongoing fees for such services as investments or insurance don't have the same risk of being reduced or terminated by regulators.

To set up such fee income, CUs can offer investment services or advisor programs provided by broker-dealer CUSOs. Property and casualty services can also be a good source of fee revenue.

Another major benefit of CUSO collaboration is increasing profit margin by reducing operational costs. "Operational services for all the credit unions in this country have a $28 billion per year price tag," Messick reported. "The most effective way to save money is bulk purchasing. The bigger the customer base you bring to a vendor, the more valuable you are"—with more power to negotiate.

Open Technology Solutions LLC (*open-techs.com*), Centennial, Colorado, is an important example of this, noted Messick, "a watermark moment for collaboration." The CUSO was initially formed by two CUs, Bellco Credit Union (*bellco.org*), Greenwood Village, Colorado, and Bethpage Federal Credit Union (*bethpagefcu.coop*), Bethpage, New York—both large, multi-billion-dollar organizations. "They can afford to do IT on their own," he continued, but by joining forces, the CUSO generated $4 million per year in savings for each CU. Today, it continues to save "millions of dollars in cutting deals with vendors" for its expanded group of CU partners.

Big data, often thought of as a silver bullet for CUs looking to compete, can cause big problems when not managed correctly, cautioned Messick—like when he received a direct mail gift promotion for an engraved diamond necklace *for his ex-wife*, when he'd been happily married to his second wife for 10 years, he recalled.

CUs can't afford to make such mistakes, but many also can't afford a sophisticated analytics platform that ensures quality data. OnApproach (*onapproach.com*), a CUSO recently acquired by CUES supplier member Trellance (*trellance.com*), Tampa, Florida, offers deep data analysis that allows CUs to take on the challenge of meeting member expectations in the age of Amazon and Google.

However, take note: "An operational CUSO is a cost containment center, not a profit center," Messick concluded. And collaboration does, or should, have limits. "Every time you add another credit union, you increase the complication factor, and decrease the percent of benefit."

Danielle Dyer *is an editor at CUES.*

Four Ways CUSOs *Benefit Credit Unions*

"Credit union service organizations play an integral role in the CU system by facilitating collaboration among CUs, which is a key cooperative principle," says Dean Young, chief experience officer at CUES Supplier member PSCU (*pscu.com*), St. Petersburg, Florida. "CUSOs deliver incremental benefits to their CUs through scale buying power, partnerships with payments industry leaders and direct access to the services and solutions they need most to compete, all of which would be difficult to attain outside of the CUSO framework."

"Within the CUSO model, CUs are leveraging their collective resources to build a better industry," says Jane Hammil, VP/advisory service at CUES Supplier member CU Direct (*cudirect.com*), Ontario, California. Her group offers decision engine and system optimization services, benchmark reports, peer and market analysis, customized lending programs and consulting. "One of our missions is to help our CUs become better lenders," she adds.

"The CUSO structure enables CU Direct to outperform the largest banks by providing technology that funds more auto loans at dealerships than any other lender in the country," Hammil says. "Last year, we funded over 1.5 million loans for a total of $45 billion for CUs."

Indeed, by pooling their resources, CUs can better compete with big banks. "At its core, PSCU helps owner CUs take advantage of opportunities and solve problems," says Young. "By helping CUs gain access to payments solutions, technology and functionalities that might otherwise be cost-prohibitive, PSCU saves owners substantial operating costs, provides them access to higher levels of expertise and adds alternative streams of income."

The CUSO benefits don't stop at technology. Many CUSOs provide industry benchmarking and consultative services.

Hammil shares an example of a CU that's working with her group at CU Direct to improve its loan decision engine, enabling automated loan approvals. The CU has plans to put off hiring a new underwriter, at a cost savings of about $80,000 in salary and benefits expenses. Plus, CU Direct has found that loans are up to 63 percent more likely to be funded when approval is instant.

Business intelligence is a third way CUs can benefit from working with CUSOs. At PSCU, "business intelligence and insights, curated from data and analytics, and consulting expertise that enables CUs to serve members with targeted promotional efforts, ensure that marketing dollars are invested where they are likely to see the highest return and success," says Young.

Alone, "CUs may not have the expertise and technology at their disposal to perform the deep analysis that drives their decisions," says Hammil. "Our clients use us as a business intelligence department because we have the hands-on expertise to help them execute their business plans."

Finally, many CUSOs, like CUs, offer patronage dividends to their owners. PSCU owner CUs earned a $24.2 million dividend in 2018, 25 percent of which was an immediate cash payment.

Imagine the Possibilities:

The Benefits of Partnering with PSCU

By PSCU

"Your possibilities delivered." When combined, these three relatively simple words come together to create a promise from credit union service organization PSCU – one backed by over four decades of experience, 1,500 credit unions with 59 million members served, two billion unique transactions per year, over $210 million in fraud savings for members in 2018 and 2,100 employees ready to act as an extension of our Owner credit unions. No matter your credit union's strategic priorities, PSCU is dedicated to delivering new possibilities through a highly integrated suite of payments solutions and renowned commitment to service in order to provide your members with the experience they have come to know and expect from their trusted banking partner.

Possibilities in the Digital Era

In an increasingly digital world, PSCU's commitment to its credit unions includes assisting them in providing the personalized experience that credit union members desire. Remarkably, the human side of the credit union narrative is as relevant today as it was 100 years ago even with the increase in digital and mobile engagement as adoption of these payments methods continues to rise. For credit unions, CUSOs function as the quintessential bookends on the digital-to-human experience, and CUSOs are committed to helping credit unions navigate this journey.

What, then, can credit unions do to improve the member experience in the digital space, and how can CUSOs help? If the end goal is to develop long-term competitive and financial success, PSCU recommends applying these three principles:

1. *Shift the focus of service from cost reduction to experience enhancement.*

   While some companies view service as a "cost center," PSCU views it as tangible desire – something we want to do, not something we have to do. We encourage credit unions to share this view, knowing that a shift in perspective can veritably alter outcomes. While efficiency has its use, it is not always well-suited to solving members' problems.

   One of the great challenges for credit unions is that they can have a roving eye – a general focus on the members they do not have, rather than the ones they do. In taking steps to improve the member experience, credit unions must focus on finding ways to delight existing members. Now is the time to place strategic importance on the value of current members and the contributions of your service representatives, who essentially serve as ambassadors of your brand.

2. *Grow member-facing teams to be proactive, not reactive.*

   Train your member-facing staff to identify and resolve member issues before they become a problem. This can take on a number of forms, from FAQs and forums, to knowledge base and instructional videos. Perhaps most notoriously, it can simply mean picking up the phone to call and check on members when certain events within the community might have impacted them. When applied properly, this approach not only helps you stay engaged in your members' lives, but it also engages with them in a way that builds loyalty and decreases support calls.

3. *Engage start-to-finish throughout the member journey.*

   Members want to feel valued when they engage with your credit union. To truly enhance the member experience, credit unions must engage with members before issues arise, as well as after a solution has been delivered. Relevant seminar, webinar and e-learning opportunities are additional ways to engage your members, show them you care and elevate their experience with your credit union brand.

Turning Possibilities into Realities

Since its founding, PSCU has invested – and will continue to invest – in transaction processing, fraud prevention, digital payments, loyalty rewards, data analytics programs and contact center support to give all of our Owners the competitive edge they need to excel in their markets. PSCU feels that the real value and success of a CUSO is in fact defined by the success of our Owners and how well the CUSO serves its credit unions and their members. For many, that means making their possibilities a reality, and PSCU does just that.

Adopting New Loan Origination Technology Produces Record Loan Growth for Pacific Service

Provided in collaboration with CU Direct's Research and Insights division.

To achieve 18% annualized loan growth, a credit union needs a robust and efficient loan origination system. For Pacific Service Credit Union, Lending 360 was the right loan origination system to get the job done.

Chief Lending Officer and SVP, Chris Oldag, knew that his competitive market and tech savvy members required an LOS with a robust API interface that supports mobile and digital solutions and provides quick decisioning.

"You can't miss the commercials or browse for anything loan related online without getting an onslaught of 'click here' fintech streamlined approaches to access credit," he said. "The last thing any of us wanted was an anvil for an LOS when it comes to the member or staff experience."

Since going live with Lending 360 in April 2017, Pacific Service has grown its consumer loan portfolio from $253 million to $401 million, representing a whopping 58.5% net growth. Pacific Service processes all of its consumer loans on the LOS, which includes direct and indirect auto loans, credit cards, second mortgage/home equity loans and credit lines, motorcycle/RV/boat loans and unsecured loans.

The credit union leveraged the loan origination system's automated decisioning engine and cross selling tools to fuel that amazing growth.

"We experienced positive balance growth in every consumer category, including our unsecured loans, by automating the decisions and adding a 'click here' option to accept a 100% automated unsecured loan up to $10,000," Oldag explained. Pacific Service developed an automated workflow that funded the loans and put the funds into qualified member accounts (existing members with tier 1 or tier 2 membership status) within 60 seconds, he added.

With all that growth, surely Pacific Service had to compromise loan quality, right? Wrong. As of year-end 2018, the credit union reported just 0.04% delinquencies and has averaged around 0.20% charge offs since implementing the LOS.

In part, that's because while Pacific Service still uses judgmental underwriting, about 30% of its loan approvals are automated by Lending 360, Oldag said. Additionally, a large percentage of members are pre-screened approved. "That leaves time for us to focus on the tough ones," he explained. "The controls and variables we've built into the system have helped our team look for more opportunities. They are now able to look for ways to build an application that is weak or has challenges."

Lending 360's underwriting efficiencies have also allowed Pacific Service to spend more time improving the quality of indirect deals and more closely track loan performance.

Not only did Lending 360 produce improved underwriting efficiencies, Pacific Service also gained operational efficiencies that, as Oldag put it, "moved the credit union out of the 'dark ages' of lending." The credit union uses the LOS' online and mobile loan application tool and currently receives about 60% of its applications through those digital channels.

The credit union was able to grow its consumer loan portfolio by 60% and only had to add three employees to boost funding – two handling indirect loans and one working direct loans. Once the credit union streamlines funding parameters required by its core, it will implement a "one and done" approach to funding which will further improve efficiencies and reduce the need for additional funding employees as it continues to grow loans.

Lending 360 didn't just allow Pacific Service's lending team to work more efficiently, it's also improved their employee experience. Oldag described the transition as like "Christmas morning, tearing open new present after new present compared to their previous primitive system. Employees learned the new system very quickly," he added.

He also noted Lending 360's reliability, responsive time to key strokes and immediate data entry were all huge improvements over the credit union's previous LOS.

Improved efficiencies and a transfer of assets from low-earning investments to loans more than doubled Pacific Service's ROA since implementing Lending 360. The credit union reported 0.32% ROA on March 31, 2017, the last day it used its old LOS. At year-end 2018, the credit union's ROA had climbed to 0.70%.

"We have positioned ourselves well for continued growth in 2019," Oldag concluded.