The Relevance and Survival of Small Credit Unions

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Table of Contents

Statement of Issue

The number of credit unions in the United States has steadily declined for several years. Of the more than 4,000 credit unions that have disappeared through mergers or closings since 1997, the asset size averages around $33 million. Meanwhile, the number of credit unions with assets in excess of $1 billion has been on the rise (Taft 2015).

The loss of those small credit unions could, over time, have a significant impact on many in the industry. If all credit unions under $100 million in assets were to disappear, does that bring an end to this trend, or does it pose a greater risk to the next tier of credit unions?

In this White Paper we will look at the following questions to help determine the survival and relevance of small credit unions:

- What is causing the decline of small credit unions?
- What does the loss of small credit unions mean for the industry?
- What can small credit unions do to survive and remain relevant?
- Are mergers a good or bad thing? For whom?

We will rely on statistical evidence of mergers and closings as well as new credit union charters. We will also look at some credit unions taking the initiative to adapt for survival. Finally, we will hear from industry leaders about new developments in regards to credit union charters and what solutions they find to be the most viable.

Introduction

Credit unions first appeared in the United States in the early 1900s. Those early cooperatives provided banking services to the unbanked members of the surrounding communities. As history proves, credit unions filled a huge void in the financial services market. By 1960, there were more than 10,000 federally chartered credit unions, each serving a small, distinct sector of the market. Over the next several decades, credit unions continuously changed, much like the rest of the public sector. Eventually, the government allowed greater membership flexibility by expanding charters (NCUA 2015).

Credit unions were evolving. Members were becoming more fiscally diverse, and the rest of the financial services industry was taking notice. Credit unions were no longer serving the population that big banks had ignored for years. Now credit unions were attracting members with substantial savings and good credit. Millions of members were being served by thousands of credit unions, many of which had fewer than a handful of branches.

Since the turn of the century, a new chapter to the history of credit unions has begun. Just as the big box retailers put pressure on mom and pop stores, larger financial institutions, including credit unions, began to acquire or drive out smaller competition that failed to adapt to changes in consumer or regulatory demands. Consolidation has become the new reality for an industry proud of its heritage and its business model. In their article, "The Big Squeeze on Small Credit Unions," *Comstock Magazine* states, "Every month, about 20 small credit unions are lost to mergers and closures. According to The Financial Brand forecasts, half of all credit unions will disappear by 2032 if trends continue at current pace" (Yoder 2015).

> *"Half of all credit unions will disappear by 2032 if trends continue at current pace." ~The Financial Brand*

Is this a big deal? A quick web search reveals that it is. Countless articles have been written on the "why, when and how" of the disappearance of small credit unions. Industry pundits spout their opinions on what will eventually save or doom the small credit union. Recently, the NCUA redefined small credit unions as those with assets less than $100 million (Chilingerian 2015) while CUNA has called for an annual index to set an adjusting definition (NAFCU 2015). For so many to weigh in on the topic, it must be a big deal, but why?

The credit union industry prides itself on being different. It is an industry defined by the sacred Credit Union Movement that is still touted today. The industry is built around the well-being of those it serves. The word "members" sits atop the organizational chart of many credit unions as a reminder that everyone is there to put the member first. The focus is not exclusively on the bottom line, but longtime "credit union people" are quick to point out that it is all the members' money so it must be managed accordingly. That mindset has developed a sense of trust with the membership that is literally passed down to future generations of credit union members.

Also, credit unions are more than just a business within the community. Credit unions are typically a part of the community, sponsoring local events or providing volunteers for community projects. When the credit union sponsor company cuts hours, the credit union responds with a loan promotion designed to get the affected members through a tough financial time. Credit Unions are able to create products and services specific to their membership or environmental circumstances. With each of those actions, trust grows. These characteristics define credit unions and separate them from banks. While the majority of credit unions operate in this manner, it is the small credit unions that exude these characteristics.

A truly small credit union is similar to a glass bottle of Coca-Cola. While it is a step back in time and may lack some of the convenience of the modern day model, there is something refreshing about its simplicity. At the same time, it lacks mass appeal for day to day use causing many people to choose modern day convenience over the old fashioned feel. All the while, the glass bottle of Coca-Cola continues to hang around in redefined relevance.

The biggest question surrounding small credit unions seems to be whether they can survive and remain relevant in the current environment. “Difficulty thriving in today’s market given the heavy compliance burdens they face, shrinking margins, lack of marketing dollars and increased competition from old and new players” are a few reasons Paul Gentile at *Credit Union Times* believes smaller credit unions will need to seek help from others (Gentile 2015). To survive, small credit unions will have to look into alternatives. They will have to reject the status quo and look outside the box for their own glass bottle approach.

Credit Unions will need to continue to differentiate themselves from - while still competing with - banks. “A recent survey conducted by the FINRA Financial Investor Education Foundation found that more than half of Millennials believe little to nothing sets their bank apart. While these numbers may scare some credit unions, others will see this as an opportunity,” says Chirag Patel (Patel 2014). The ability to compete with banks will be a necessity and require full product lists and a knowledgeable staff. Also, without this differentiation, regulators will have more ammunition to treat credit unions like banks, including taxation.

Change will be necessary. Why would it not be? Today’s credit unions do not even remotely resemble the original credit unions of the early 1900’s so it is unlikely that the plan for continued success strongly resembles what we see today. Credit unions will have to alter their models without compromising their values, but the existing model does not necessarily need to be abandoned. The original credit union model could be the father of the highly successful “crowdfunding” used by entrepreneurs today, proving that foundation is still sustainable. How credit unions choose to redesign what they build upon that foundation could be the difference in long term viability or eventual merger.

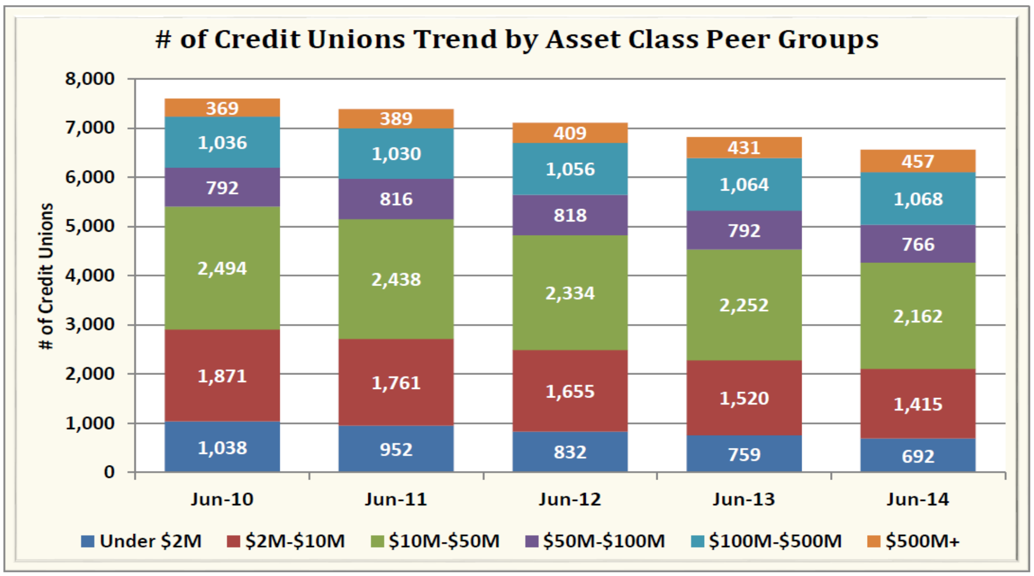
Sound planning will be imperative as small credit unions look to succeed in the future. Small credit union management may be forced to rely more heavily on experts outside of their organization to aid in strategic planning as they seek to identify the banking needs within their community. Then those managers will likely have to step into unfamiliar territory to offer new products and services via channels they may never have used. The challenge to adapt will be great, and the adaptation must be done swiftly but carefully.

It is important to note that not all credit unions will survive, and that does not in and of itself indicate a failure. Each credit union should serve a greater purpose than mere existence. Making changes only to prolong an inevitable merger may cause more harm to the industry in the long run. Likewise, mergers should not be used as a quick and easy exit strategy. But if credit union leaders truly believe that their first priority is serving the member, then the idea of a merger should never be ruled out of consideration, nor should it be a given. The honorable thing to do is keep all options on the table and make decisions with the best interests of the membership at heart.

The success of the industry as a whole is built upon serving the members. That will never change. What will change is how to best serve the members. Members, of course, have been the heart and soul of the credit union journey since the beginning. Small credit unions will have to find ways to meet the modern day demands placed on a financial institution, including the demand of its members, otherwise, the journey will come to an end.

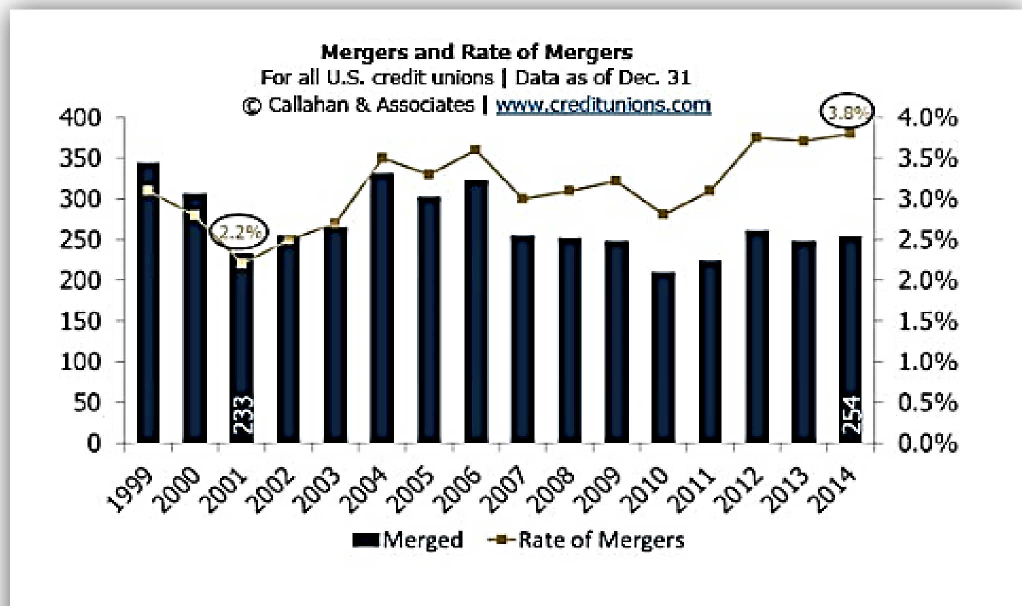
Research

Small credit unions are in a period of undeniable decline. From 2010 to 2014, credit unions under $100 million in assets have declined by 1,160. Over the same period, credit unions over $100 million in assets have increased by 120. (CUDATA LLC) While it is safe to assume some credit unions simply grew beyond the $100 million threshold, it does not diminish the significance of the trend.



CU Data LLC

Since 2004, approximately 250 credit unions are lost to mergers annually. As the number of annual mergers holds steady while the number of credit unions decreases, this means that the rate of mergers is actually increasing slightly over time. In 2014, there were 254 credit union mergers with an average asset size of $22.8 million. Credit unions below $20 million in assets have accounted for 78% of credit union mergers since 2009. (Taft 2015) But mergers are not the problem for small credit unions. Mergers are the byproduct of growing challenges across the credit union landscape. We will examine some of the main challenges below.



Source: Peer-to-Peer Analytics by Callahan & Associates

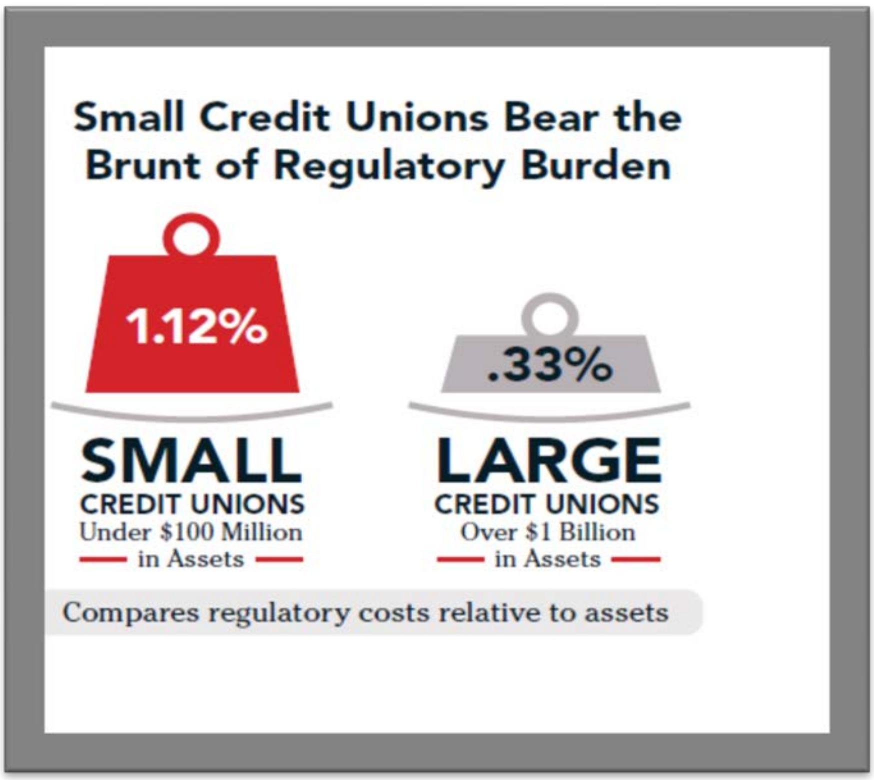
In our survey of credit union personnel, 88% of respondents selected both regulatory compliance and the rising costs of technology as the largest reasons for the loss of small credit unions. The third most common reason small credit unions are disappearing, according to our survey, is the inability to reach the credit union's target market, which was selected by 38% of those surveyed. (Survey Monkey)

Complying with Regulation

Regulation is one of the hottest topics at credit union conferences and round tables nationwide. Legislation such as the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act has placed a heavy compliance burden on all financial institutions with thousands of pages of complex demands. While more than 25% of credit unions have hired additional compliance staff, small credit unions are trying to remain compliant with minimal staff. (Yoder 2014)

There are layers of obstacles that come out of these regulatory changes. Credit unions have to abide by both federal and state laws. The National Credit Union Administration (NCUA) and the Consumer Financial Protection Bureau are continuously addressing issues that could have major implications for credit unions. There is an increased demand on the manpower required to remain compliant. There are new costs for legal fees, loan documents, and staff training. Revenue streams have been reduced, cutoff, or bypassed for the sake of compliance. "Intense regulation and compliance are major challenges that take one away from his or her true mission," said Randall Robinson, President of the $65 million SC National Guard Federal Credit Union. (Robinson Interview)

The Credit Union National Association (CUNA) commissioned Cornerstone Associates to conduct a study of the costs associated with regulatory compliance. The study found that the additional cost of regulatory compliance associated with changes enacted between 2010 and 2014 resulted in an additional $1.7 billion in expense across the industry in 2014. This is on top of preexisting compliance costs. Cornerstone Associates noted, "The study found that the costs that credit unions bear as a result of regulation, even when conservatively measured, are very high, and have increased substantially since the financial crisis and the Great Recession. The burden is particularly egregious for smaller institutions." (Baumann 2016)



Hampel 2014

Large institutions are facing similar challenges when it comes to regulation, but the impact is greater on small credit unions that are spreading the costs over a smaller asset base. (Baumann 2016) The growing complexity of the regulatory environment leaves some (but not all) small credit unions lacking the sophistication required to remain compliant.

The Cornerstone study shows that the regulatory cost to assets ratio is more than three times greater in small credit unions. Beyond the direct cost of increased regulation is the lost revenue, a figure much more difficult to measure. Small credit unions may have abandoned products and services or forgone new opportunities in an effort to avoid the regulatory burden. Regulatory changes in mortgage lending make it difficult for small credit unions to stay in the mortgage business. Even when conservatively measured, credit unions lost $1.1 billion in interchange revenue alone because of the Durbin Amendment to the Dodd Frank Act alone from 2010 to 2014. (Hampel 2014)

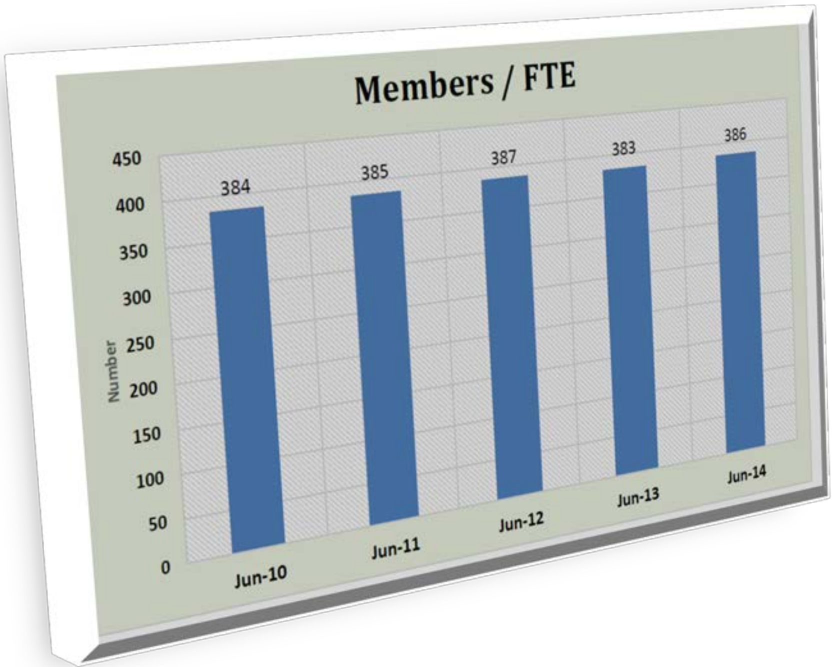
Not only has increased regulation hurt the existing small credit unions, but it has also made it more difficult for new cooperatives to enter the market. On average, only two new credit unions are chartered each year. Of those newly chartered credit unions, only 50% survive the first five years. (McGarvey 2013) Why is it so difficult for a new credit union to get established? Ron McLean, Senior Vice President of the Credit Union Association of New York said, "Chartering a credit union certainly has become more difficult in the past decade as the complexity involved in operating a credit union has increased significantly. Regulations alone and the increased regulatory burden make operating a credit union more challenging for the staff, leadership and board." (Muckian 2015)

Adopting New Technology

The next major challenge facing small credit unions is meeting the technology needs of the modern member. This is an issue that leads to a strategic planning crossroads for many small institutions. Members are looking for an institution that provides convenience through the latest technology. Implementation of that technology requires a significant financial investment, but the failure to do so could be more costly in the years to come as members move their business in pursuit of convenience.

Again we see economies of scale come into play. The cost of developing a mobile app does not depend on the asset size or the number of members of a credit union, allowing $500 million credit unions to invest the same $10,000 for development as $50 million credit unions. The difference in scale makes it easier for larger credit unions to adopt newer technology while the small credit union is still feeling the impact of the initial investment.

Many articles tout the cost savings provided by products such as mobile banking and remote deposit capture, but Mike Schenk of CUNA cautioned in *Comstock's* "The Big Squeeze on Small Credit Unions" that "new online options don't replace telephone and in-branch banking. Many customers still want to talk to someone in person, especially when they're dealing with more complex financial transactions like getting a loan." (Yoder 2016) Instead of saving money, these products create a new layer of expenses. Plus there is no concrete evidence that shows an overall cost savings generated by technology. As processes have become more automated, and teller stations have been replaced with kiosks, 2014 data from CUNA shows that the members to fulltime equivalent employees ratio has remained virtually unchanged since 2010, hovering around 385 to 1. (Muckian 2015)



CUDATA LLC

There may be fewer tellers, but IT departments have expanded. The previous statement may pay dividends to institutions with hundreds of employees, but it does not work out as efficiently with a small staff.

Not only is the infrastructure of technology costly, but the ongoing management and maintenance can be overwhelming as well, putting a heavy burden on a staff of four with no formal IT background. The Credit Union Association of Rhode Island offers a technology consulting service to assist with technology policy development and adoption of best practices. Their website states, “While creating new opportunities for success, technology also creates new opportunities for fraud and loss. Protecting against robbery was a matter of investment in traditional security devices such as video cameras, alarms, and risk management staff training. Robbery and mismanagement were the menaces of the past. Hacking is the new risk. Credit unions must be vigilant, make the necessary decisions and investments to protect their operations.” (Morawski 2016) This statement shows that in addition to set up cost and maintenance, credit unions also face new areas of exposure to risk and losses. Even so, technology is a must- have survival tool in today’s competitive financial services market.

Reaching Target Audience

A business must be able to reach its target audience in order to survive. This burden is not unique to small credit unions, but it appears to be more challenging for them. David Brock, CEO of the $540 million Community Credit Union of Florida said, “Organizational awareness is the hallmark of competitiveness. In the fragmented society we live in, with all the different preferences for receiving information, the cost and complexity of securing brand awareness is high. The primary challenge is always to be relevant to member/consumer needs”. (Brock Interview)

Credit unions must retain existing members and attract new members and then get the most out of those two groups. Unfortunately, many small credit unions have an aging member base that points to an inability to reach new, younger members. Older members usually hold a significant portion of total share balances in a credit union, which is an excellent resource, but credit unions need the younger generation to balance the equation. Joe Sullivan, CEO and Founder of *Market Insights*, said, “Customers 65 years of age or older have migrated from asset accumulation to asset depletion. While they may hold higher deposit balances, their need for loans, credit cards, etc. diminishes. They become less profitable. Moreover, small institutions are already starting to feel the impact of long-time, loyal older customers dying and their accounts transferring to children and grandchildren in other parts of the country.” (Sullivan 2014)

Speaking at the 2015 National Directors Roundtable Conference, NCUA Chairman Debbie Matz voiced her concerns about an aging membership base and the need to attract younger members. “If the trend of aging credit union membership continues,” Matz said, “many credit unions may have no future. A credit union cannot survive without lending, but the average age of credit union members is over 47. This is critical, because the peak borrowing years are between ages 25 and 44, which means the average member is already past those peak years. Young demographics are huge potential markets. Thirty-three percent of the U.S. population is under age 20, yet young demographics are underserved by credit unions. Members between ages 18 and 24, account for just nine percent of credit union membership.” (Matz 2015)

Now credit unions are faced with courting the business of Millennials. Scratch, a division of Viacom Media, conducted a three year study titled “The Millennial Disruption Index” that found financial services to be at a high risk for disruption from the largest generation in American history. In the study, 73% of Millennials would be more excited about financial services offered by Apple, Google, or other tech giants than they would from their own institution. Additionally, one third of Millennials believe they will not need a financial institution at all in five years. (Scratch 2013) This means small credit unions are fighting for the attention of a generation that does not even believe that the current banking system meets their needs.

Millennials may not be completely accurate in their predictions, but credit unions, in particular small credit unions, should take notice. When you combine the number of Millennials with the idea that they are projected to inherit $30 trillion from their Baby Boomer parents in the coming years, (Matz 2016) it becomes clear that their ideas cannot be ignored.

"If you transform your credit union to serve the next generation and if you meet them where they are and serve their unique needs, your credit union will still matter." ~ Debbie Matz

Regulation, Technology, and Marketing Collide

In order for small credit unions to remain relevant, each of the above challenges must be addressed. Debbie Matz addressed the attendees at the 2016 CUNA Governmental Affairs Conference by saying, "For each of us to do our jobs, we must all stay ahead of the curve. Making Millennials into members, keeping pace with evolving technology, and adopting strong cyber-security measures will determine the future of your credit union. If you transform your credit union to serve the next generation and if you meet them where they are and serve their unique needs, your credit union will still matter." (Matz 2016)

An institution cannot simply focus on investing in technology while failing to effectively market their services and ignoring regulation. Technology will be a key feature for survival, but it must be well marketed. Traditional advertising will have to take a back seat to technology driven advertising. At the same time if recent history is any indication of the future, both the technology itself and the marketing of financial services will likely be more heavily regulated. Unfortunately, there are not many $50 million credit unions that can afford to have a tech genius, a marketing guru, and a compliance expert on staff because they are unable to create the necessary economies of scale.

Other Challenges

There are other threats to a small credit union's survival that may not be as well documented but are every bit as real.

"Another cause of death, and a surprisingly common one, is what some experts call "aging out" of an institution's leadership, meaning the CEO and the board of directors. Few have succession plans in place. Faced with the need for a new CEO, some institutions decide that it is just simpler to merge the institution out of existence". (McGarvey 2013) One of the difficulties small credit unions face with succession planning is the inability to retain younger talent. Some small credit unions cannot afford the wages required to keep that talent on the payroll. Others provide little to no opportunity for growth and development for a potential successor.

These factors leave some boards unwilling to take on the challenge of finding a suitable leader to carry the organization forward after the aging leadership retires. “The problem is usually in securing talent that is strong enough, has ambition, and doesn’t shrink from the challenge,” said Brock. (Brock Interview)

The Outlook

The above challenges are daunting and are unlikely to subside. Still, 81% of respondents to our survey believe small credit unions can remain viable, with 63% of respondents citing collaboration as the key. More than half of those who believe in the future viability of small credit unions work for credit unions with over $100 million in assets, meaning this is not just a feeling of self-belief held by those working for small credit unions. (Survey Monkey)

Collaboration

Collaboration is a growing trend among small credit unions that combines the cooperative spirit historically found in credit unions with the desire for self-preservation. It can take on many forms and be implemented to various degrees.

Roughly 60 Southern California credit unions, most with less than $100 million in assets, have come together to form the Southern California Credit Union Alliance (SCCUA) with the goal of reducing operating expense and making new endeavors more affordable. SCCUA meets quarterly to openly discuss industry concerns and methods of further collaboration. They have also negotiated with select vendors to offer discounts to member credit unions. One of those vendors is an insurance company that has saved SCCUA credit unions thousands of dollars. Other benefits include two free training seminars a year and an annual conference. The group has adopted the slogan “We’re better together” to reflect their commitment to surviving through collaborating. (Molvig 2012)

Three California credit unions have taken collaboration to a new level as they each share the same CEO. Each credit union is under $100 million in assets, but they have combined assets of more than $150 million. CEO Jon Hernandez points out that the collaboration extends beyond the top executive office. “We share certain positions the credit unions can’t afford individually. For example, a compliance officer or technology officer, a real estate loan person, a marketing director. Those are dedicated positions we each wish we had, so we share between two or even among all three credit unions,” said Hernandez.

> *“A shared CEO model is not the right approach for everyone, but I believe the industry needs more collaboration.”*
> *~ Jon Hernandez*

Hernandez sees collaboration as one of the primary keys to survival, but admits that each institution must find what works best for them. “A shared CEO model is not the right approach for everyone, but I believe the industry needs more collaboration. Smaller and mid-size credit unions, specifically, just don't have the economy of scale we need. If we collaborate with one another, there’s a much better chance we'll continue to serve our members and thrive,” he said. (Wessler 2015)

Pennsylvania based Everence Federal Credit Union is spearheading a project as one of six small to mid-sized credit unions from the Mid-Atlantic region that have partnered to share back office functions. The idea is to take the processes that have little to no impact on the member, such as compliance and vendor management, and combine them to create efficiencies and scale that would not be available to any of those credit unions individually. (Ochalla 2013)

Ohio HealthCare Federal Credit Union CEO Bill Butler has taken a different route. He secured a Trade, Industry, and Profession (TIP) charter as a way to expand his credit union’s footprint in the state of Ohio. The TIP charter allows him to serve all healthcare professionals in the state, rather than serving only one hospital system. He then reached out to the ten other hospital credit unions in the state, inviting them to merge into his charter. The selling point was that each merging credit union could retain its identity in name, but reap the rewards of an expanded field of membership. To date, one of those ten hospital credit unions has merged into his TIP charter, but he believes that others will follow in the future to take advantage of scale (Ochalla 2013). Since 2013, Ohio HealthCare FCU has grown from $50 million in assets to over $70 million. (5300 Call Report)

Butler’s plan is a version of the network credit union model that has very recently gained traction. NCUA Vice Chairman Rick Metsger spoke at CUNA’s Governmental Affairs Conference, where he discussed the benefits available to small credit unions under this model. The idea originated in Canada as a way to permit multiple credit unions to come together under one charter, but retain their individual identities. Although technically a merger, it allows the merging institutions to continue using their branding while offering expanded services to their members. “One of the advantages for this credit union that is looking for alternatives and does not want to lose its identity, is that under the network model, it could continue to operate under its own name, in terms of how it is visible to its own members,” Metsger said. (Young 2016)

> *“Death of the small credit union does not have to be a pre-ordained conclusion”*
> *~ Rick Metsger*

The network credit union has been ruled as permissible under the Federal Credit Union Act and NCUA bylaws. Metsger also offers assurances that the NCUA will not create unnecessary hurdles if credit unions look to move in that direction. His hope is that this will prevent struggling credit unions from waiting until the NCUA forces a merger. “The time to move from rhetoric to reality is now,” Metsger said. “Death of the small credit union does not have to be a pre-ordained conclusion.” (Young 2016)

Credit Union Service Organizations (CUSOs) are another form of collaboration that give credit unions other options as they can look to invest in CUSOs that meet their needs, or form their own CUSO. CUSOs provide the opportunity to offer new services, such as business lending or to improve back office processes like information technology and accounting. (Ochalla 2013)

Mike Atkins is the CEO of Open Technology Solutions (OTS), a CUSO formed by three credit unions from three different states. The purpose of OTS is to provide IT services for the three owner credit unions in an effort to pool resources and reduce expenses. The CUSO also yields a collective bargaining power that is greater than what may be available to each credit union individually. Atkins touts the opportunity for innovation provided by CUSOs. “When you build a CUSO, you have the opportunity to do some really innovative things that you wouldn’t be able to do otherwise, since they’re not bound by the same rules as a credit union,” said Atkins. (Ochalla 2013)

Recommendations and Solutions

No solution will ensure relevance and survival among all small credit unions. The truth is that no industry has a 100% success rate, and the credit union industry is no different. Regardless of efforts, not all plans will succeed. There will be challenges and obstacles that will not be overcome, but some pathways to success exist for those credit unions that choose to position themselves for the future.

The final result may be hybrids of several different avenues or consist of multiple plans and programs. Solutions can vary depending on the environment, market, and membership, factors that are largely beyond the control of any board or management team. Credit unions will need to tailor a plan that fits their individual situation as there is no one size fits all approach. Small credit unions will have to do their homework, assess their strengths and weaknesses, and create a viable strategic plan, which most credit unions claim to do. The difference is that these plans must be built for the future of the industry. For many credit unions this may look like a marked departure from what they have been doing. We have identified a few elements that are vital to research and evaluate prior to deciding a final path to a relevant survivorship.

The authors of this paper have identified a few elements that are vital for a credit union to research and evaluate prior to choosing a new path to a relevant survivorship. Assuming that our reader, you, are interested in helping your credit union to survive and thrive, where do you begin?

Where to Start

It is imperative to first determine a big picture for your credit union. Work together with the management team and the board of directors to establish a vision for the future of the credit union. Plan where you want to go and what types of risk you are willing to take to get there. Design a plan specific for risk and growth. Determine your short and long term goals. Ensure all of these steps are done with consideration of fiscal limitations. Then set up tasks to allow your team to continue to look at your plan and to adjust as necessary. Make certain the team has fully answered the following questions:

- Where do you stand in the market place?
- What products do your members want?
- What aspects does your team do well?
- Where does your credit union struggle?
- Where does your credit union stand financially?
- Is your financial situation sustainable? If so, for how long?
- What are the financial challenges for your credit union?

Joe Sullivan wrote an article for *The Financial Brand* entitled, “Evolve or Die: 3 Steps Small Banks and Credit Unions Must Take Now” that focuses on your market place and servicing specific demographics. He considers the age of your market and the needs of that age group. Sullivan encourages you to look at how that market has changed and how you believe it will change in the future (Sullivan 2014).

Here is a plan of market assessment as presented by Sullivan:

- Research the market place by assessing:
    - The long term trajectory of specific markets
    - The degree that urbanization may erode the specific market
    - Whether and where jobs will be created or lost
    - How age (younger and older) will change your services
    - How the competition will be in five year
- Refine what needs to be changed by assessing the target market:
    - Has your target audience changed given changes in your markets?
    - Does your message need to be modified given these changes?
- Reposition resources to accommodate the new market needs and wants

While many small credit unions sit comfortably in the midst of their established ways and past successes, the world around them is in a state of constant transformation. Failing to adapt to those changes is the first step towards failure. The competitive market now dictates that all small credit unions be in a state of constant and honest evaluation.

Collaboration/Association

Research shows a movement toward greater collaboration within the industry. What alternatives can you take into consideration? Could you collaborate with other credit unions to reduce costs or introduce new products to your membership? Developing relationships or forming associations with other credit unions is an innovative way of sharing costs and spreading risk associated with new endeavors. Consider sharing your credit union’s strengths in exchange for assistance in areas of weakness. This could allow you to offer additional benefits or services, making you more attractive to your current or potential members. It might also allow you to become more competitive in your market. As the SCCUA’s slogan states, “We’re better together.”

Another possibility is to unite with other small credit unions around a common weakness. This idea could take on multiple looks. For example, find other credit unions that struggle with compliance and structure a cohesive group that can research, implement and manage any regulatory or guideline changes across the entire group. Marketing is another area that could benefit from an association, especially for credit unions with a comparable field of membership, such as medical or military. Neither marketing nor compliance partnerships should be limited by geography as modern technology has made distance a non-factor, deepening the pool of potential partners.

You are probably familiar with the cliché “People are our greatest asset” that is commonly used in the business world. While some people like to add their own qualifiers to this phrase, or challenge its validity altogether, let us assume for our purposes that it is indeed true. Now think about the possibilities that arise from sharing those same “great assets” with other institutions as we again look to the areas of marketing and compliance.

Most small credit unions do not employ a full-time marketing professional. Often, marketing duties are divided among an already thin staff or given to the staff member with the smallest workload, regardless of his or her skill level. Other credit unions contract with outside agencies that can be costly. But why should small credit unions have to choose between subpar marketing efforts or the potential high cost of an outside consultant? What if two or more credit unions were to make formal arrangements to share a marketing professional? Each of the credit unions could now have the expertise of a marketing professional at a fraction of the price.

Why stop the employee sharing with marketing? What about compliance and human resources? These roles may not be necessary for forty hours each week, but when you need them, you want to be confident that the situation is being handled by someone with the proper knowledge and experience. Employee sharing will come with its challenges, but the benefits are clear. Earlier, we told you about three California credit unions sharing a single CEO. These credit unions found a way to make the sharing model work for the greater good of all three institutions. While in a perfect world, each organization could afford to staff all positions with the proper personnel, the reality is that sometimes credit unions must work together to generate the greatest benefit.

Technology remains a costly part of operations but an imperative part of banking in today’s market. Members expect online banking, mobile banking, and mobile payment services. Keeping up with the constantly changing demands of electronic communication and banking, can prove to be cost prohibitive. With collaboration, you could divide these expenses between multiple credit unions with a shared platform.

Collaboration would help create efficiencies within a small credit union. Tasks, which were once handled manually by a group that had little or no experience, can now be managed by a more knowledgeable group with the appropriate software and procedures. These operational efficiencies can lessen expenses, providing more time for other projects. Staff that was once marginally knowledgeable and wearing many hats can focus on one area and share knowledge across the association.

Small credit unions need to explore the options provided by CUSOs. Many CUSOs already exist that allow small credit unions to offer services that they would never be able to offer on their own. The National Association of Credit Union Service Organizations (NACUSO) offers a data base of over 140 member CUSOs that is searchable by state and/or service category (NACUSO 2016). Services available through existing CUSOs range from mortgage origination services to call centers. A strong CUSO is an opportunity to function with the services and expertise of a large institution without solely funding an expensive, compliance heavy endeavor like a mortgage center.

Some credit unions will be able to look to their league for help. State leagues around the country offer assistance with ALM, BSA, training, and planning in addition to being advocates for the industry; however, the shrinking pool of credit unions has also taken its toll as many leagues have consolidated. Still, the league remains a valuable resource for small credit unions.

Merger

Merging is a difficult topic to address, but it is something that some small credit unions need to at least consider. For many small credit unions a merger is the proverbial elephant in the room that is overlooked in meeting after meeting. We are not advocating in favor of mergers, but we are advocating for informed planning, which includes considering all options.

Human nature leads people to protect the vision and integrity of the brand they had a hand in creating. Beyond that, “credit union people” truly believe in the mission behind that brand so they see a merger as more than the loss of a brand; they see it as the loss of the community they formed together with their members.

Merger conversations must be based on strategic considerations rather than emotions. Discussing a merger is a way of being open to change, not admitting defeat. Still, many managers of small credit unions see it this way. An anonymous credit union CEO sees pride as a major obstacle to voluntary mergers. He said, “They see merger as a failure rather than a benefit to members, so they will only merge at the inflection point of a CEO retirement or financial stress” (Strozniak 2015).

A merger might be perceived differently when it is the credit union’s choice and not their only option. If a credit union is able to take the time to do the proper research, rather than to allow themselves to be pushed toward a merger by regulators, the option could be desirable. Examining the possibility of a merger proactively, would allow a credit union to find potential merger partners with similar visions, giving management and their board of directors the opportunity to choose their fate.

If a merger could be a solution for your credit union, exploring this option sooner rather than later could be beneficial. Your options for merger partners will be more diverse when your credit union is not in a position where you have to merge. Looking into a merger while the health of the credit union is respectable might give smaller credit unions some leverage in negotiations such as retaining current staff.

The stigma of a merger needs to be retired. A merger does not have to be a negative solution. A preemptive merger could benefit two smaller credit unions, looking to gain economies of scale while maintaining significant influence in the direction of the organization. Merging with a small local credit union with congruent visions and values could have a larger impact on the community while providing the ability to compete with the bigger institutions. The Credit Union Team of Kaufman and Canoles has predicted this model will be a growing trend. “For credit unions that are $100 million or less in assets, this regulatory burden has made such a financial impact that even with a strong financial position, these credit unions, in 2016, may seek merger partners. The difference, however, will be that mergers in 2016 will be by and between strong credit unions with a mutual goal of improving member service and increased opportunities to members” (DeVore 2016).

Smaller credit unions with comparable interests or membership SEGs (Select Employer Group) could consolidate to create a larger presence. Consider, for example, the numerous postal credit unions across the United States. The state of New York alone has nine active postal credit unions while the NCUA still reports 13 others that are no longer in existence (ncua.gov). We are not suggesting that all of these credit unions merge to form one mega postal credit union, but it seems logical that some of these credit unions would merge to protect the identity of a proud SEG.

Other possibilities are the multiple credit unions that serve the same corporations in different states, such as the Nucor Steel Corporation served by credit unions in both Alabama and South Carolina. Technology has removed some of the geographical barriers pertaining to mergers across state lines although challenges with state regulations could arise. Another example would be credit unions servicing medical professionals. The membership characteristics are similar; together the smaller credit unions would be able to offer a wider variety of services or products tailored to those members.

Then there is the aforementioned network credit union model that we see as the future of the industry in many ways. On the surface it looks like the best of both worlds as a credit union can gain scale without losing identity; however, digging deeper into the issue, questions quickly arise. Which employees stay and in what capacity? How will the composition of the board of directors be determined? What efficiencies do traditional mergers provide that a network merger does not? The questions will be plentiful but so will the opportunities. Small credit unions will have to proceed cautiously down this path as it is a permanent change, unlike associations and cost sharing arrangements.

The fear that arises from a merger-happy culture is that it will eventually have a negative effect on the credit union industry and the credit union movement. As the number of small credit unions dwindles and the billion dollar credit union count increases, the target on the back of the credit union industry will only grow. Banks are already aggressively calling for more regulations for credit unions and lobbying against credit unions' tax exempt status. Whether or not small credit unions are able to thrive in the future may have a huge impact in the bank versus credit union battle.

Conclusion

The group preparing this White Paper consisted of individuals from two small credit unions under $100 million, one credit union at $530 million, and two credit unions over $1 billion in asset sizes. This allowed for a broad perspective and good assortment of ideas. It was clear how certain scenarios or issues could affect our credit unions differently. It was also very clear that each individual was very passionate about their work and their credit union's model.

Some of the solutions listed are actively being pursued within the credit unions of our group members which offered additional insight. Some of the group members have worked on a merger and see that to be a viable solution. Others currently have CUSOs that supply a service or product to smaller credit unions that they otherwise could not offer. We found the possibility of networking to be interesting and a great alternative to a merger.

Now we must clarify the terms "survival" and "relevance". These are somewhat abstract concepts that were debated amongst the authors of this whitepaper.

We will begin with survival, which is defined by Merriam-Webster as "the state… of continuing to live or exist especially in spite of difficult conditions" (Merrian-Webster online). A more casual, yet vivid, definition would be "not dead". Survival, on its own, means very little in the business world. There are a number of businesses that are surviving that are not necessarily succeeding.

Relevance is being important in a particular setting, or more casually stated, it means you matter. Relevance should be the minimum standard a business wishes to achieve.

Survival is the precursor to relevance as a credit union has to stay alive in order to matter. Some members of our group considered the idea that a merged credit union has technically survived as its members have been moved into another group of members. In the end, we determined that survival is tied to maintaining an identity or brand, in which case only mergers in a network credit union where the branding is retained would be considered survival.

Relevance goes a step beyond survival where, for the foreseeable future and barring the unexpected, the ability to survive is not in question. Relevant credit unions have a defined place in the market, be it a large presence in a particular region or a small, but solid, niche market.

It is definitely no secret that the number of small credit unions is declining. Survival and relevance is dependent upon a credit union's willingness to change. With the prediction that 50% of credit unions will disappear by 2032, the time to act is now. We believe that this forecast can be changed and the next five years will tell the story. Survival solutions will be diverse and look different for everyone. There is no universal plan. This becomes quite clear in the research and the opinions of our group.

Solutions are available but small credit unions will have to make a plan and put that plan into action with the knowledge that this plan will likely change in the years to come. Opportunities abound for credit unions and the future looks bright if small credit unions are willing to look closely at their current model, understanding that modifications must be made to remain relevant. Credit unions need to look to the future, rather than to the past or the present, as antiquated or even current ways of thinking may leave little chance of survival.

We, as an industry, largely view the present circumstances through our own limited experiences and context. We think that the challenges of today are unprecedented. George W. Mitchell, a former member of the Board of Governors of the Federal Reserve said, "There is apprehension about the survival of the small or moderate-sized community bank. Will it suffer the same eclipse in economic significance as the corner grocery and independent merchant? Or will it somehow struggle through these new challenges and emerge onto the new frontiers of banking, modernized but still preserving the sturdy independent tradition?" (Sullivan 2014). What is striking about that quote is that he said it in 1966.

Mitchell provides us with greater context. He shows us that small credit unions were fighting for survival and relevance 50 years ago. The challenges have changed over time, but they have always been there. These words should offer encouragement for the journey ahead.

Individual Take-Aways

Renée Sanders, Purdue Federal Credit Union, $1 Billion

I found some of the solutions for smaller credit unions to be interesting. Purdue Federal has completed mergers in the past and currently has a CUSO for mortgages so smaller credit unions can offer mortgage products to their members. The success of our CUSO is dependent on the productivity of these small credit unions and currently suffers for this exact reason. Therefore, I concluded the options that were nontraditional to be more intriguing. I am eager to dig deeper into Networking and what possible nontraditional opportunities we have for our CUSO.

I also found that even though we are a credit union, we can sometimes be viewed differently due to our size. Overall, I feel all credit unions believe in the credit union model and will fight hard for its survival. It's a team that cannot be broken.

Brad Hayes, Community Credit Union of Florida, $530 Million

Excellent, more personal customer service, remains at the heart and root of survival. Older members (such as boomers and older) relate to it – but so do younger members. The concept of *"smaller" and "local" goes along with the recent push among Millennials to "shop local" and to support small businesses. This mindset is evident in places such as grocery stores that advertise some foods as "locally grown" and use that as a selling point. Knowing who grows one's food is akin to knowing who is holding one's money. There is a recent desire to return to the "small and local" as opposed to the "large and corporate" which appeals to members of all age. This trend bodes well for small credit unions that can maintain personalize service for their member while adapting to a changing landscape.*

<u>*Travis Hall, South Carolina National Guard FCU, $65 Million*</u>

This topic resonated with me on a personal level. I spent the first eight years of my career working with dozens of credit unions as an auditor. I have worked with "one-man-shop" credit unions and heard them speak of their struggles. Now I am working for a $65 million institution that almost exclusively serves a single SEG. Because of my past and present experiences, I was not all that shocked by the data we found in our research.

Since taking this job in 2014, I have often wondered about the long term viability of my organization as well as other credit unions like my own. As I have been researching this topic I have had several conversations with my President as well as my contacts at other credit unions about plans for the future. While at times I am overwhelmed by the looming struggle ahead, other times I am excited about a future ripe with opportunity. I do believe there is a market for small credit unions in the future, but it will be up to the community of small credit unions to remain relevant.

<u>*Ian Kijanski, Excel FCU, $97 Million*</u>

The research involved in composing this paper reinforced the simple idea that relevance is not dependent on survival, but survival is dependent on relevance. So much of the research decided for a small credit union to remain relevant they (the small credit unions) must collaborate to stem the rising costs associated with new technology, compliance, marketing, etc. While this is fundamentally correct, the question is does this make the credit union relevant or will this simply postpone the inevitable merger or ultimate closing of the credit union?

Relevance is dependent on research into the membership of the credit union and its geographic demographics. A small credit union in a very rural setting is and should be ingrained in the local community. Their size while dependent on the community population is not in danger because they have or should have a significant presence in "their" population. They know their members' wants and deliver services based on their members' needs. Their survival is more assured because if they conduct themselves correctly by their members, they will remain relevant to their community.

Zana Bramlett, Associated CU, $1.4 Billion

As our team started our discussion on The Relevance and Survival of Small Credit Unions, I had not actually thought much about this topic. The credit union that I work for is a 1.4 billion dollar credit union and well capitalized, the thought never crossed my mind as to our survival and relevance. As the team started our research, I became all too familiar with how many challenges that small credit unions face each day, and the how and why they can or can't be relevant and survive going forward in the future. The first thing that I thought was how lucky that I am that I work for a credit union that even with the challenges will likely weather the storm. The second thing is the overall challenges that small credit unions are facing now and in the future. The decrease in the credit unions that currently exist compared to how many existed 20 years ago truly surprised me. I knew the economic impact over the years impacted the existence of credit unions but the current and future challenges could do even more damage to the small credit unions in particular.

Relevance and Survival of Small Credit Unions

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