

Best Practices in Credit Union Efficiency

*A White Paper Commissioned by
CUNA's Community Credit Union Committee*

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A NEW MANDATE FOR COMMUNITY CREDIT UNIONS

Credit unions in 2010 are operating in an environment filled with anxiety, guarded optimism and pure exhaustion from the tolls of what we now call the "Great Recession." An era of buoyant growth and complacent risk-taking is now dead and gone. Those protecting and furthering the cause of the credit union movement have a tougher job now – one that will require tenacity, creativity and greater sophistication in managing a cooperative financial institution.

This new era for credit unions will be especially significant for community-based institutions. The past decade saw a huge rise in community credit union charters throughout the United States. As corporate mergers and restructures rattled the traditional job market, credit unions began to view local communities as a more viable avenue of growth than the traditional SEG-based path. The promise was enticing: open up the benefits of not for profit cooperative finance to greater numbers by drastically simplifying field of membership eligibility. "Can I join?" – "Of course you can; we're open to everyone in the community."

The massive transition of hundreds of institutions to community charter created an interesting "chicken and egg" challenge for these credit unions. This challenge centered on adding resources in terms of branches, marketing, staff, etc. to take advantage of this newfound channel of growth. Credit unions did not want to add the resources without the business to support it but had little confidence they could create this new business without adding the resources.

As we look now toward the other side of the Great Recession, community credit unions are situated with a cost and efficiency "hangover" – much of the investments made in the promise of growth have not generated adequate returns. It's time for community credit unions to take stock on their cost structures amidst a new, competitive environment.

CUNA is proud to offer this valuable whitepaper titled **Best Practices in Credit Union Efficiency**. The paper was commissioned by **The Community Credit Union Committee**. In order to examine best practices in efficiency, CUNA has asked Cornerstone Advisors, Inc., a leading consulting firm specializing in strategy, operations and technology, to create this study.

We hope this report can serve as a useful guide for your credit union's diligent efforts to improve operating efficiencies.

PERFORMANCE COMPARISONS FOR COMMUNITY CREDIT UNIONS

The mandate for improved efficiencies in community credit unions is clearly supported by industry data. Roughly 2,000 of the 8,000 credit unions nationwide have community powers, and there are some noticeable differences in the expense and revenue structures of these institutions.

Community Credit Unions Tend to be Larger on Average

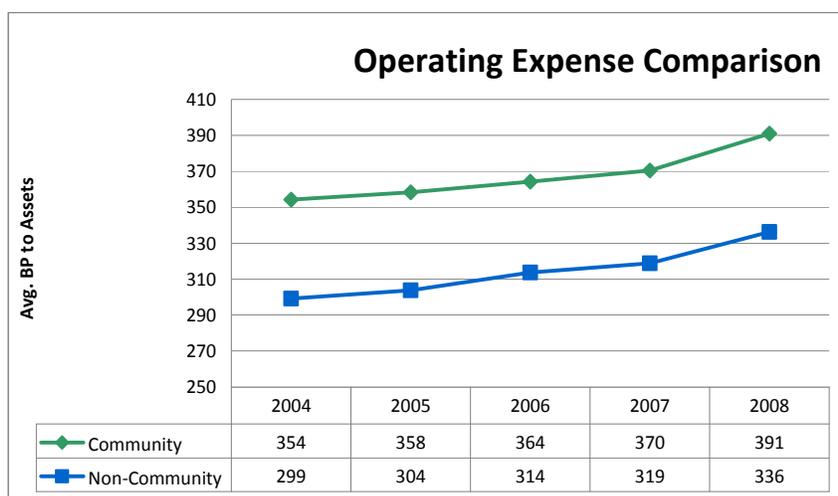
While community credit unions make up one-fourth of the number of credit unions in America, they comprise 34% or roughly \$300 billion in total assets. The table below shows a few interesting comparisons between community and non-community credit unions:

	Community Credit Union	Non-Community Credit Union
Number of institutions	2,006	5,747
Total members	33.5 million	57.8 million
Total assets of institutions	\$305 billion	\$581 billion
Average size of institution	\$152 million	\$101 million
Average number of employees	46.7	25.3

Source: CUNA 9/30/09

Operating Expenses are Higher at Community Credit Unions

Industry data also reveals the sizable disadvantage that community credit unions have over non-community credit unions when it comes to operating expenses. From 2004 – 2008, community credit unions operated at an average operating expense to assets ratio of 3.68% vs. 3.14% for non-community credit unions. Because of dramatic movement in both expense and income during 2009 due to NCUA assessments and losses from ownership in corporate credit unions, we have excluded these figures from the graph.



Source: CUNA

This 50+ bp disadvantage in operating expense is clearly a challenge for community credit unions operating in a razor-thin, commodity business like consumer financial services. Detailed analysis and plans need to be made by credit unions to “tap the brakes” and bring down this ratio to a more competitive level in the next 3 – 5 years.

Community Credit Unions are Less Efficient than Banks

In addition to a disadvantage vs. credit union peers, community credit unions also demonstrate a disadvantage when compared to community banks. The table below summarizes key performance ratios between community credit unions, banks under \$10 billion in total asset size (nearly all of these institutions are community-focused) and all banks nationwide.

	Community Credit Union	Community Bank	All Banks
Operating Expenses/Assets	3.68%	3.20%	2.77%
Net Interest Income	3.38%	3.28%	2.70%
Non-Interest Income	1.40%	1.09%	1.56%
Efficiency Ratio	77%	73%	65%

Source: CUNA and FDIC

As the table reveals, community credit unions operate at higher expense ratios than community banks and all banks nationwide. It is important to note that community credit unions have a slightly higher net interest margin than both small and large banks, and an advantage in non-interest income vs. community banks.

Comparing the overall efficiency of financial institutions is sometimes best accomplished with the final measurement in the table above known as the *efficiency ratio*. This ratio is popular within the banking industry and often used by stock analysts to rate the efficiency of a publicly traded bank. The formula for the efficiency ratio is as follows:

$$\text{Efficiency Ratio} = \frac{\text{a) Non Interest Expense}}{\text{b) Net Interest Income and c) Non-Interest Income}}$$

The efficiency ratio is essentially a figure that reveals how much operating expense is required to create a dollar in revenue. Like a golf score, a lower efficiency ratio is better. As can be seen in the table above, community credit unions operate at a 77% efficiency ratio, meaning it takes 77 cents of operating expense to earn a dollar of revenue. Meanwhile community banks only take 73 cents and all banks only take 65 cents. Setting efficiency ratio goals for the future should be a high priority item for community credit union managers. There are several high-performing credit unions nationwide that have set long-term targets to move toward a 50% efficiency ratio. Cornerstone Advisors, Inc. recommends that all credit unions target at least a ratio below 70% and more optimally somewhere between 60 – 65%.

Like all measurements, however, the efficiency ratio does have some weaknesses. Some credit unions have decided that the efficiency ratio is not appropriate for our credit union as it is more of a bank ratio and not a good fit for credit unions. These credit unions see a conflict between achieving a strong efficiency ratio and keeping a member-driven pricing philosophy that offers competitive loan and dividend rates and minimal fees. In effect, credit unions often pass the benefits of member ownership on via competitive pricing, and this serves to hurt the overall efficiency ratio. For the most part, this debate about the efficiency ratio can best be arbitrated by a balanced scorecard philosophy in the credit union’s strategy process. Certainly, efficiency is important, but it must be balanced against other strategic priorities such as member value, service quality, risk management and growth.

Explanations for Operating Cost Differences

One of the natural questions that emerges from these industry operating cost comparisons is, “Why do community credit unions have higher operating expenses?” There are several common explanations that include:

Branch facilities – Community credit unions typically have moved to expand by building additional branch facilities. While this may have helped to grow deposits and drive fee income related to more checking accounts, it adds expense in both facilities and people to staff the branch. Data from CUNA seems to support this hypothesis. As the table below shows, 80% of the operating cost differences between community credit unions and non-community credit unions are explained by three major cost categories in the NCUA 5300 reporting. It should be noted that office occupancy and operations costs for non-community credit unions are often subsidized via special arrangements with SEGs where the credit union operates, contributing somewhat to these facility-related differences.

	Community Credit Union	Non-Community Credit Union
Office Occupancy	28bp	22bp
Office Operations	67bp	59bp
Compensation/Fringe	176bp	151bp
Total People and Office	271bp	232bp

Source: CUNA

Cost of Member Acquisition and Retention – Another cost difference between community and non-community credit unions centers around the marketing and sales costs required to both acquire and retain members. The traditional bond between a credit union member and his/her SEG employer has historically resulted in greater loyalty and more efficient forms of marketing. For instance, promotional messages in company newsletters or common practices to sign new employees up for the credit union greatly lower the cost of member acquisition and product sales. A community credit union working to acquire new members with no awareness of the credit union may require more expensive advertising, direct marketing and even sales incentives to drive growth. The table below demonstrates the difference in cost for Education/Promotion Services between community and non-community credit unions from 2004 – 2008. On a relative basis, community credit unions spend almost 50% more than non-community credit unions in this area.

To put this into a real-dollar perspective, a community-based \$500 million credit union would spend \$250,000 more in education/promotion each year than a non-community peer of exactly the same size.

	Community Credit Union	Non-Community Credit Union
Education and Promotion Costs	16bp	11bp

Source: CUNA

These factors help explain why community credit unions have an efficiency challenge and disadvantage over other types of institutions.

MAKING EFFICIENCY A TOP PRIORITY

For community credit unions, improving profitability and protecting net worth in the years ahead will require a laser focus on ongoing tenacity around efficiency improvement.

Since the financial crisis first hit in September 2008, all credit unions have begun to make serious expense cuts. We have seen reduced marketing budgets, canceled conferences, salary freezes and select cases of employee layoffs. These efforts will begin to dent the overall cost curve for community credit unions, but getting operating expenses to a level that positions credit unions for the next few decades of competition will take much more.

Credit unions that succeed at bending their operating cost curves will acknowledge that being a non-profit does not excuse the organization from driving efficiency but rather mandates that every penny of member money be used wisely. And, as opposed to merely counting paper clips and canceling a conference visit, the real progress will come from more sophisticated and disciplined approaches to efficiency management.

The great efficient community credit unions of the future will:

- Set high-level objectives or “BHAGs” (big hairy audacious goals) as part of the strategic planning process
- Utilize benchmarking data to assess efficiency across all areas of the credit union and report these measurements regularly
- Set accountabilities and incentives around efficiency improvement at all levels of the credit union
- Establish a culture of continuous process improvement and drive new efficiencies with disciplined project management
- Leverage growing self service channels (phone, Web, mobile, cards) to deliver financial services in a less labor-intensive manner and actively manage channel delivery costs

- Utilize sophisticated data mining and contextual marketing strategies to lower the cost of member acquisition, cross sell and retention
- Develop stronger profitability reporting information at the branch, product and member level and drive management decisions around this profitability information.

In the next chapters of this report, Cornerstone Advisors, Inc. will share select benchmarks and best practices and provide actionable advice to community credit unions starting their journey toward greater efficiency.

BRANCH DELIVERY

If one were to inspect the payroll records and operating expenses at any community credit union, they would quickly determine that branches consume a large portion of employees, facility costs and certain technology costs. Branch efficiency and profitability must be one of the key strategies for any community credit union working to be more efficient.

Across all financial institutions (banks, savings and loans, credit unions), there has been a dramatic explosion of branches over the past decade. Inspired by former leaders in retail banking growth such as Washington Mutual (failed and taken over by JP Morgan Chase) and Commerce Bank of New Jersey (sold at a high multiple to TD Bank in Canada), banks and credit unions alike saw branching as their primary engine of growth. While best practice leaders may have seen impressive numbers with new branching, the average financial institution expressed much more mixed results in branch expansion.

Leading branch research firm Bancography reported in 2008 that the average bank branch built in 2001 had only \$17 million in deposits by 2008. Interestingly, many of these branches were constructed with *pro forma* plans and business cases that anticipated somewhere between \$30 and \$50 million in deposits at the five year mark, meaning that a large portion of branch expansion in the United States fell below management expectations.

Unfortunately, branch data for credit unions similar to the robust information available from the bank FDIC agency is not available from NCUA or any other source. However, ongoing analysis and client engagements by Cornerstone Advisors, Inc. confirm that the “below expectations” new branch has been a common occurrence in credit union land.

Analyzing Your Branch Costs

One of the first steps credit unions should take in creating branch efficiency is to conduct a comprehensive and transparent review of their branches today. While some credit unions have deployed powerful profitability software to track branch performance, most credit unions will need to carry out a more *ad hoc* analysis or build reports that attempt to estimate branch profitability based upon information available. To the extent that your credit unions “branch accounting” capabilities allow it, management should develop clear branch scorecards that highlight the current size, volume and profitability of the branch network.

The sample branch *pro forma* on the following page illustrates the type of best practice report needed for management to monitor branch profitability:

**Acme Credit Union – Branch Profitability Report
(\$000s)**

	Branch 1	Branch 2	Branch 3	Branch 4
Total Deposits	\$111,000	\$32,000	\$17,000	\$6,000
Total Loans	\$121,000	\$27,000	\$4,000	\$11,000
Interest on Loans	\$7,200	\$1,300	\$980	\$600
Cost of Deposits	(\$4,000)	\$85	\$45	(\$23)
Costs/Income from Internal Funds Transfer	(\$36)	\$15	\$68	(\$25)
Non-Interest Income	\$1,100	\$345	\$145	\$34
Direct Expenses	\$2,100	\$1,300	\$1,100	\$950
Direct Profit Contribution	\$2,164	\$455	\$138	(\$364)
Allocated Expenses	(\$1,000)	(\$400)	(\$250)	(\$275)
Net Profit After Allocations	\$1,164	\$55	(\$112)	(\$639)
ROA	.96%	.14%	-.66%	-5.85%

This type of branch profitability can be very helpful in allowing credit unions to isolate where inefficiency is occurring in the retail system and to create action plans with branches regarding:

- Growing profitable branches
- Fixing branches that are unprofitable but have strong growth potential
- Closing/selling branches that are unprofitable and do not have strong growth prospects

Many credit unions have either lacked the analysis or intestinal fortitude to address low performing branches in the past. Banks tend to close poor branches much faster than credit unions. However, the new competitive environment will demand that credit unions be more transparent and forthright in dealing with those branches not making the profitability cut.

Clearly these decisions are not “black and white.” Other factors such as branch convenience, member usage of a facility and support of other product lines (e.g. investments, mortgage) needs to be considered, but holding on wishfully to unprofitable branches because they add “intangible” value is a certain recipe for credit union inefficiency.

Optimizing Branch Performance

In addition to a more global branch profitability analysis, it is important for credit unions to employ key staffing and performance benchmarks to manage branch productivity. It is safe to say that many credit union branches have excess staff today when both existing and new business volumes are considered. These benchmark type metrics can also be used as the basis for formal branch staffing models. Staffing

models ensure that credit unions are more rational and fair in how staff resources are allocated versus partaking in “squeaky wheel” syndrome in which branches that complain they are busy get more staff.

In analyzing branch staff, Cornerstone Advisors, Inc. recommends metrics be established in key functional areas such as:

- Branch managers and assistant branch managers
- Branch “platform” staff that sell and service member accounts
- Branch teller staff that service member transactions

While branch roles and job descriptions vary between different credit unions, these functional drivers can act as good benchmarks to compare to peers. A few highlights from the extensive benchmarks that Cornerstone Advisors, Inc. develops in their Cornerstone Report credit union scorecard include:

	Peer Median	Peer High Performer
Average Deposits Per Branch	\$57 million	\$80.6 million
Average New Accounts Per Platform FTE	85	126
Total Existing Accounts Serviced Per Platform FTE	3,608	5,140
Average Transactions Per Teller Per Month	2,616	3,495

Note: Data provided with permission from Cornerstone Advisors, Inc. – [The Cornerstone Report 2008](#). Peer data includes credit unions \$350 million and above. High Performer credit union measure indicates the 75th percentile level of performance.

Credit unions looking to improve their branch productivity have a number of key projects and initiatives they should consider:

New member/new account process streamlining – Often, one of the more time-consuming and frustrating processes within the branch is the new member/new account process. System limitations, paperwork and the re-keying of data can not only consume staff time, but also create a sub-par member experience. Credit unions should flowchart their current opening process and develop specific improvement plans that include streamlining data collection, building automated interfaces to your new accounts system for activities such as check ordering, card ordering, online banking and bill pay enrollment, CHEX systems and OFAC compliance. In addition, credit unions are working to provide more systematic “onboarding” processes for new members where branches are regularly communicating, advising and tracking the cross-sell of their new relationships. Management may not be paying enough attention to this critical process within your credit union.

Improved back office support via imaging/intranet technologies – Continued increases in activities concerning regulations, bank secrecy and administrative mandates have created a “tax” on branch productivity. A deeper analysis of your branch activities may indicate that paper forms, tracking logs and requests for information from credit union headquarters are eating away at branch staff productivity.

Many credit unions have addressed this challenge by leveraging their intranet and document imaging systems. They have built automated work flows for anything that the front office needs to send to the back office such as account maintenance requests, research, or compliance reporting. Leveraging these technologies in the credit union branch environment should be a high priority for branch managers and CIOs alike.

Teller staffing models and use of part/peak time staff – Data from Cornerstone Advisors, Inc. indicates that the median credit union uses peak or part time staffing for 30% of its branch headcount. These flexible staffing plans have allowed credit unions to maintain member service while reducing overall costs. Employing formal staffing models that account for hours during the day/week with heavy volume can add more precision and cost-saving opportunities for this process.

Check 21 capture at branch (teller back office) or teller line – The branch teller process is being made less paper intensive by deploying branch capture, either at each teller’s workstation or at the “back counter” of the branch. These initiatives have served to reduce branch courier costs and allow credit unions to better manage their funds float process.

Member retention strategies to reduce churn – One of the key areas to improve branch profitability is improving member retention so work done in the branches is not essentially rework to maintain the same size credit union. Watching “churn” is especially important for checking or share draft accounts. Credit unions can improve both their reporting and communication strategies to keep a high retention rate among their most active members.

Automated dashboard performance/sales reporting and referral management – In recent years, many credit unions have worked to create more active sales and service cultures. By being more proactive about what the credit union offers, branches can work to increase member share of wallet. However, the birth of sales culture has also resulted in certain sales reporting processes that can be cumbersome and inefficient. Credit unions should look to better automate how sales are tracked and how referrals are monitored between the branches and other areas such as mortgage, investment and business services. This is typically a broken process that needs attention.

Creative strategies to use branch “slack” time productively – Walk into many credit union branches today and it may look more like a museum than a financial services business. With the growth of Internet and electronic payments, branch transactions have tended to flatten, and certain branches in a credit union’s network may be quiet. In many cases, staff needs to be in these branches for coverage and “dual control” operational reasons. Therefore, management needs to find ways to keep this staff productive when members are not walking through the door. Creative financial institutions have begun to use outbound calls, loan processing, account maintenance and call center coverage as ways to utilize branch staff effectively in a more flexible and virtual environment.

Back Office Retail Operations

In addition to the front-line branches, credit unions need to focus on the efficiencies and processes in their back office functions. Regulatory requirements, fraud and even mergers are placing new strain on

credit union back offices, and most of these operational departments have tended to grow in an evolutionary and haphazard fashion – they were not organized and designed with process efficiency in mind.

2010 is a wonderful time for credit unions to take a fresh look at their back office operations. Key performance improvement initiatives should include:

Full imaging of documents with automated work flows around their capture and maintenance –

Imaging or “enterprise content management” systems open up amazing new process efficiency opportunities for credit unions. Leading institutions are working to build paperless environments in which documents are captured electronically and then accessed, routed and reported throughout the organization using automated work flows embedded in these imaging systems. For instance, an account closed in the branches can be automatically imaged and archived for the back office, and indexes attached to these images can then allow for the credit union to access the documents via a simple search of name, Social Security Number, address, etc. in seconds.

Improved usage of data warehouse and Web-based dashboard tools for automated reporting –

Back office functions often spend time creating reports for management or auditors by extracting information, typing it into spreadsheets and formatting it into board books and other documents. Leading credit unions have done comprehensive audits of the reports they use and have worked to leverage data warehouse and dashboard technologies in their organizations. It is hard work, but automating ongoing reports can save days of staff time each month.

Integration of fraud management tools – Another key function of the back office is to monitor and manage potential fraud activity. In addition, back office functions have been very involved in anti-money laundering and Bank Secrecy Act (BSA) compliance mandates. Best practice credit unions are beginning to leverage new integrated fraud and compliance platforms to automate these activities and leverage more sophisticated rules for catching fraud or reporting suspicious activity for regulatory purposes. This is a growing area of expertise that credit unions will need for the future.

Integrating Web-based forms from front-line with back-end core systems for work flow purposes –

As was previously mentioned in the branch section of this report, best practice credit unions have become zealots about using their intranets to improve productivity. They have automated processes and even built interfaces to their core systems to eliminate paper and re-keying of data whenever possible.

REMOTE DELIVERY

One of the key opportunities for credit unions in the future is to better leverage remote delivery services to reduce the labor-intensity of their cost structures. While the branch will play an important role for most credit unions, the power of having members “pump their own gas” is clearly evident. As an illustration, look at the operating expense figures for Internet only bank ING Direct and Internet and call center focused Alliant Credit Union when compared to community credit unions:

	ING Direct	Alliant Credit Union	Community Credit Unions
Operating Expenses as a % of Average Assets	.72%	1.35%	3.68%

Source: CUNA and NCUA call reports

Some credit unions worry that increased usage of remote channels versus the physical branch will result in members feeling ignored or losing that personal touch. However, several large financial industry studies have shown that active Internet banking and bill pay customers tend to be more satisfied with their banking relationship than the average customer. These remote delivery channels enhance the overall service experience for members with 24/7 availability, robust information and the feeling of control it gives them.

Therefore, credit unions should look to their remote channels as both an efficiency strategy and a source of member service/convenience. The first step in attacking channel costs is to build some type of transparent Channel Delivery Scorecard in your organization. This scorecard should be used by the board and management to track the usage of traditional and e-channels by members. If growth is not occurring in the less costly channels, management can investigate root causes and build marketing/service strategies to improve penetration. For instance, many credit unions have as yet to see an uptick in members using the Internet to open new accounts. By digging into usability and member behaviors, the credit union can work to improve the usage of this channel.

A sample Channel scorecard format is provided below:

Acme Credit Union - Channel Delivery Scorecard				
Branch Channel	Current QTR.	Last QTR.	Same QTR. Last Year	Goal
# of monthly transactions per teller FTE				
# of new accounts per platform FTE				
Telephone Channel				
# of calls to call center per month				
# of calls to automated voice response per month				
# of loans originated per call center FTE per month				
# of new deposit accounts per call center FTE per month				
Calls per call center FTE per day				
Internet Channel				
# of members enrolled in Internet banking				
Active Internet customers as a % of checking households				
# of customers enrolled in bill pay				
Active bill pay as a % of checking households				
# of e-statements viewed online				
# of check orders received online				
# of loan payments made online				
# of credit card payments made online				
# of online account transfers (internal)				
ATM/Debit/ACH/EFT				
Average transactions per ATM/month				
Debit cards as a % of checking accounts				
Average monthly transactions per debit card				

These types of management reports can help ensure the credit union is focusing on the growth of cheaper and highly valued remote channels.

Telephone Banking

While the Internet revolution is having a dramatic impact on member delivery, the plain old telephone channel continues to be both a popular and powerful efficiency strategy for credit unions. Creating not only an efficient but personalized and high-service experience for members is very important. Today, best practice credit unions are achieving higher levels of performance in their credit unions by:

Managing with balanced incentive plans for agents – Credit unions have designed scorecards that reward call centers not only for productivity but also for high levels of service and sales/cross-sell activity. Instead of a chaotic administrative function, these best practice call centers have become top notch virtual branches for members.

Improved integration of technology for easier agent navigation – Just like a branch platform environment, credit unions need to audit and improve the processes needed for call center agents to do their jobs. Fragmented systems and manual tracking of items can be extremely frustrating and serve to increase the average member call time for no productive reason. Credit unions are working to build more integrated “portals” for call center agents to conduct all of their work activities.

Better leverage of skills-based routing and CTI (screen pops) – Two key technologies for the call center that credit unions have not leveraged fully are skills-based routing and computer telephony integration or CTI. Skills-based routing allows calls to go to the very best qualified agent based upon selections members have made on the phone menu. A loan selection can quickly route the member to a loan trained and certified agent. CTI allows the call center agent to receive a screen pop of the member’s profile immediately upon answering the phone to heighten the level of personalized member service.

Integrated contact management with branches – One of the most important priorities inside a call center is for the agent to know everything that is “going on” with the member when talking to him/her. A key system being leveraged by credit unions is contact management software. This system allows the credit union to record conversations/requests from members into a database that can be accessed by any employee in the credit union. When a call center agent answers a member call, they can speak intelligently about the status of member items and be more acquainted with their preferences and history with the credit union.

Integration with Web, e-mail channels – Another growing trend among credit union call centers is the evolution to true contact centers that support not only voice telephone, but all e-mail and Web inquiries from members. Many credit union contact centers now have specialized staff and work flows to handle e-mails, Web inquiry (“contact us”) and even live chat activity. By providing a seamless connection between Web and live personal channels, the contact center ensures high levels of member service but also ensures that unnecessary “back and forth” is avoided in fulfilling a member request.

Web and Mobile Banking

Leveraging the Web and growing mobile channels also provide credit unions a route to stronger efficiency levels. The Web has long been touted as a way to improve member retention and loyalty. However, credit unions have also tended to downplay the great efficiency opportunities that the Web provides. Take a look at all the member-related processes in the credit union, from transferring money to accepting loan payments, to changing an address, renewing a CD or ordering checks. Now, collect the monthly volumes for these more member-service type activities and analyze how many of these are being executed through your Web channel today. What your credit union will find is that a minute portion of this activity is happening via the Internet. Dramatic growth in the usage of self service can help your credit union grow without having to add future back office or branch staff, thus improving efficiency. How does your credit union know it is extracting this efficiency opportunity if it is not tracking this data today?

Cornerstone Advisors, Inc. reports that the ratio of active Internet users to checking accounts in credit unions is 61% with high performers at 70%.

The Web also provides credit unions a powerful vehicle to improve the efficiency of marketing and cross-selling to members. Think of the difference between a costly radio and print advertisement when compared to the “free” spectrum available through a credit union’s own Internet channel. The problem: most credit unions have barely tapped the potential of their Web channel to engage members.

To better leverage the Internet as a marketing vehicle, credit unions must:

- Improve matrix marketing at the point of log-in – specific messages can be presented to members based upon their profile and usage of products and services within the credit union
- Develop engaging content linked to product solutions – it is time to move past brochure ware and help educate members with interesting content and “tools” to help them manage their financial lives
- Personalize the Web experience – credit unions are beginning to provide better tools and information so members can see summary snapshots of their financial lives

In addition, credit unions are just beginning to tap into the potential of the Web as a member acquisition channel. Although volumes are still low today when compared to traditional account opening channels, credit unions are beginning to work on streamlined, user-friendly new member/account/funding capabilities. Over time, this growth of remote acquisition can also improve productivity in the credit union. By offering a broad menu of Web products and services, credit unions can begin to better monetize their investment in this channel, which so far has been used primarily for basic information viewing and transactions by the member.

RETAIL FEE INCOME

While the topic of fee income falls somewhat outside of an operating efficiency discussion, maintaining a solid contribution of non-interest income is clearly one of the great future challenges to the credit union business model. In the past decade, the majority of community credit unions have driven increases in both checking overdraft and card-related, non-interest income. The current regulatory and economic environment has put headwinds into the growth of these fees. First, new guidelines by the Federal Reserve concerning the opt-in for overdrafts at the ATM and point-of-sale are anticipated to pinch overdraft income by anywhere from 10% to 35%. Over the next 12 months, credit unions will begin to get a feel for how the overall opt-in levels will shake out. Additionally, a more conservative consumer may not spend as much through the debit and credit card channels, thus driving interchange income. Finally, legislation has already been drafted in Congress that would create more competition for interchange rates to merchants and thus drive down the average interchange margin that accrues to banks and credit unions. Taken together, these trends mean that credit unions must become more disciplined and creative about the retail products and payments strategies. Credit unions will work to balance providing strong value to members on their payments services with the need to somehow “pay the freight” on providing the convenience of checking and electronic services. Already, credit unions are looking to product packages that promote active card usage and adoption of lower cost delivery methods (e.g. online banking, e-statements) as a new model to replace the Free Checking with fees approach that has dominated retail banking for the past decade. In addition, credit unions may begin to experiment with certain usage and balance fees as a means of replacing lost overdraft and interchange income.

CONSUMER LENDING

While the Great Recession has curtailed consumer spending and borrowing, many credit unions have pushed ahead with consumer lending because of the competitive void opened up from large banks and other wounded national financial players. With future opportunities in mind, credit unions are working to reinvent the consumer lending process with an eye toward stronger risk management, more disciplined pricing and greater automated efficiencies.

So far, credit unions have made solid progress in leveraging tools such as automated scoring and Web-based lending. Benchmark data from Cornerstone Advisors, Inc. indicates the following:

	Median Credit Union	High Performing Credit Union
% of loans approved where auto-decisioning was used	20%	34.5%
% of loan applications originated through the Internet	13%	24.30%

Source: Cornerstone Advisors, Inc.

Going forward, credit unions will be looking to improve the overall sophistication of their underwriting processes. In the past, too many institutions merely used a simple credit score based matrix to approve loans (e.g. FICO greater than 640 gets approval). The financial crisis has proven the limits of such a blunt and brittle approach to analyzing credit risk. Instead, credit unions are now working to improve analytics around the borrower’s income/financials and the transaction/collateral specifics. They are mining their own data more actively to determine where credit risk may emerge and where loans need to be priced at a premium due to higher credit risk. In creating these new processes, credit unions have found the need to improve their origination systems and streamline both the collection and analysis of this deeper borrower and transaction data.

Additionally, credit unions are bolstering their online lending capabilities. While Cornerstone Advisors, Inc.’s median showed 13% of consumer lending applications coming through the Internet, best practice institutions have already reached 50% and beyond. What is your credit union’s goal today? To drive greater Web application penetration, credit unions are carefully looking through each step in the Web application process to ensure that it is member friendly. Additionally, new account opening tools are creating the ability to authenticate a consumer, enroll a new member and approve a new loan in a single Web encounter. This may open up new growth and efficiency opportunities for credit unions if the capability is married with active outside marketing efforts.

Finally, credit unions are working to dramatically streamline the overall process flow for a consumer loan. *The Cornerstone Report 2008 reveals that the average credit union closes 30 consumer loans per month per full-time employee involved in the lending process with 43 loans closed per month for high performers.* This benchmark ratio includes the allocation of branch staff time taken to fulfill consumer loan applications and closings.

Key improvement initiatives that credit unions are pursuing to improve consumer lending productivity include:

- Streamlining processes while dealing with regulations centered around open ended lending
- Improving systems to have better underwriting tools/routines that account for debt ratios, loan-to-value and deal terms in addition to credit scores
- Moving to electronic capture of loan documents and signatures at the front line

Better visibility of consumer lending benchmarks inside your credit union coupled with a keen focus on automation in your origination system and Web channels are high priorities today.

MORTGAGE LENDING

In recent years, credit unions have seen a growing niche emerge in mortgage lending. While both credit union management and regulators have taken note that some of this portfolio-based mortgage lending can be risky (from interest rate risk especially), credit unions nonetheless have a tremendous

opportunity to gain market share while managing this business prudently. Importantly, the financial crisis in America has consumers more aware of how a mortgage loan fits into their overall financial plan – building broad-based financial relationships using the mortgage as an entry point is a growing opportunity for credit unions. However, the mortgage business is indeed highly commoditized, and margins are razor thin. Only credit unions that manage the costs of originating and servicing mortgage loans will make any of their market share gains profitable.

Key efficiency improvements that credit unions are pursuing in the mortgage business include:

Increasing the percentage of loan applications received through the Internet – *Cornerstone Report* data reveals that the median credit union took 25% of its mortgage loan applications through the Internet while high performing credit unions have this number at 55%.

Using online disclosures and review of loan documents for closing – Credit unions should view the Web as more than a place to accept mortgage loan applications. Instead the Internet is acting as a powerful platform to automate the entire mortgage lending process. Key examples today include online disclosures that borrowers can accept online without needing to be printed. Borrowers can also check the status of their mortgage application online and even review their mortgage closing documents prior to coming to the credit union to execute the mortgage. These process improvements are serving to reduce the paperwork and “back and forth” communications between the lender, borrower and third parties.

Streamlining the closing time for a mortgage refinance to less than two weeks – One of the key drivers of both member service and efficiency in the mortgage business is fast process turnaround. With the use of automated tools, online applications and trained staff, best practice credit unions are working to get refinance loans done in just a few weeks. Unfortunately, during heavy refinance booms, many lenders run 60 – 90 days in turnaround. A key to creating a fast mortgage refinance experience is the appraisal process, and best practice credit unions are using extranets and special appraiser incentives for speedy delivery to address this critical process need.

Increasing interfaces between loan origination and title, flood, PMI, appraisal resources – An important opportunity in the mortgage origination process is the growing network of business-to-business or B2B capabilities that link up players involved in the mortgage process. Credit unions need to ensure that their mortgage group has the ability to electronically order items from all outside players directly from its origination system without needing to phone, fax or e-mail. This eliminates the re-key of data and paperwork and speeds up the mortgage processing process.

Leveraging member information on mortgage application for cross-sell – One of the most inefficient processes inside of credit unions today is how the rich and valuable information on member mortgage loan applications is ignored and squandered. Best practices credit unions have recognized the great potential of leveraging the mortgage application to expand share of wallet among members. For instance, a standard check box on a mortgage application indicates a borrower is self employed. Smart credit unions will create reports of these borrowers to call on or direct market for business services. Investment account information can spur a call from one of the credit union’s trusted investment

advisors. In the future, credit unions’ attempts to offer stronger financial planning and advisory services can start with the rich data provided in a mortgage application.

ENTERPRISE RISK MANAGEMENT

The financial crisis has brought greater scrutiny to the credit union movement in terms of how it identifies and manages risk. In the past years, regulators have asked to see a more tangible focus on Enterprise Risk Management or “ERM” in their organizations.

Data from Cornerstone Advisors, Inc. indicates that the median credit union has a Risk Management related employee (defined as Audit, Compliance, Fraud, BSA, Physical and I.T. Security) for every 42 employees in the organization. This means a credit union with 200 employees would have about five employees in their risk management functions.

Clearly, credit unions should not pinch pennies on risk management when the cost of excessive risk can be deadly. Instead, credit unions should actively track the costs of managing risk, both in terms of staff and outside audit and compliance services.

In addition, credit unions need to make better usage of risk measurements and dashboards within their organizations that provide monitoring and early warning signals in the area of credit risk, interest rate and liquidity risk, operational risk and reputation risk. For example, a key operational risk measure may be fraud losses from checking accounts. Cornerstone Advisors, Inc. indicates that the median credit union loses \$4.42 dollars to fraud per checking account (both electronic and check) each year.

Most credit unions may be too small to have a dedicated Risk Management function in their organizations, but at the very least they should use an Enterprise Risk Committee and formal management processes to oversee and manage risk.

ADMINISTRATIVE SERVICES

A key way to manage a credit union’s overall efficiency is to ensure that non-member facing administrative costs do not become excessive. Just as production oriented resources like loan officers and branches are held to productivity standards, so too should administrative functions like Finance, Human Resources and Marketing. Here’s a quick rundown of a benchmark and best practices in this area.

Finance and Accounting

Cornerstone Advisors, Inc. found an accounting and finance FTE for every \$109 million in total assets. Typically, a credit union can get more efficient in the accounting function as the credit union grows. Key priorities for finance and accounting managers include leveraging automated reporting and data

warehouse tools to reduce manual report creation. In addition, many credit unions are using the intranet to streamline processes such as purchasing, employee expense reimbursement and budgeting.

Marketing

Cornerstone Advisors, Inc. found that the median credit union had one Marketing FTE for every \$180 million in assets. Marketing departments are using their own desktop publishing software to reduce outside production costs, hiring interns as inexpensive additional labor and sharing certain marketing initiatives with other credit unions. In addition, extensive data mining of the member base is proving to help. Marketing departments lower their costs to acquire and retain members. Best practice marketing departments actually segment their budget between acquisition and retention related strategies and then create measurements (e.g. marketing cost per acquired member and marketing cost per existing member) to track performance.

Human Resources

Greater and greater demands are being placed on credit union Human Resource departments in the areas of organizational development, performance management, recruiting and training. Cornerstone Advisors, Inc. found that the median credit union had an HR employee for every 72 staff members at the credit union and an FTE in the training function for every 88 credit union employees. Key efficiency improvement strategies being pursued by Human Resource departments include:

- Leveraging self-service intranet based tools for employee information, benefits elections and maintenance, training and performance management
- Using imaging systems to access critical information such as prospective employee resumes, reviews and applications
- Use part-time staff vs. adding full time employees when the HR department needs to grow
- Regular competitive bidding processes for health, retirement and payroll services.

Credit unions are increasingly reviewing outsourcing options for their administrative functions. As the Web helps outside companies integrate more effectively with credit unions, suppliers providing outsourced benefits administration, recruiting, facilities management, compliance, loan review and marketing services will be reviewed more often. A formal in-house vs. outsourced cost analysis should be used when these types of proposals are received by the credit union.

INFORMATION TECHNOLOGY

The final area for efficiency review in this white paper deals with the third largest operating expense in any credit union: information technology. Next to people and facilities, spending on computer systems is an area where prudent cost management will pay dividends for credit unions.

Cornerstone Advisors, Inc. measures technology costs as a percentage of the credit union’s total assets. The table below details spending in each of five major technology spending categories:

% of Assets			
	Median	25 th Percentile	75 th Percentile
Core Systems	.086	.061	.113
Data Communications	.038	.023	.055
Electronic Delivery Systems	.219	.140	.344
Infrastructure	.090	.060	.155
Strategic Systems	.042	.025	.062
Total	.475	.309	.729

Source: Cornerstone Advisors, Inc.

It is important to note that credit unions spend nearly twice as much relative to assets as banks of similar size. There are several explanations for this difference:

- Banks are profit focused, so they tend to be less inclined to keep their technology current and invest in technologies with a hard-dollar payoff
- Credit unions have historically had fewer branches than banks so they have needed to compensate with higher investments in remote channels such as call center, Internet, and ATM channels
- According to best practice comparisons by Cornerstone Advisors, Inc., credit unions have been fairly loose with their technology “experiments” and spending and so they manage their overall I.T. spend less effectively

Looking to the future, there are several key changes that credit unions must enact to better manage their I.T. spending:

Change #1: Review major contracts to ensure competitive pricing – Many credit unions simply sign contracts provided by vendors and fail to negotiate the best pricing. Credit unions should competitively bid and drive active contract negotiations in the following major areas:

- Core systems
- Electronic banking (debit, credit, ATM cards and networks)
- Internet banking and bill pay
- Item (check processing)
- Data and voice communications

Change #2: Improve use of tools for staff efficiency – The I.T. staff tends to be one of the busiest functions in the entire credit union, and maximizing the effectiveness of this

department’s time can pay great dividends. There are several maturing tools that are helping I.T. departments support the credit union more effectively:

- **Network management tools** – These tools help staff monitor network performance, traffic and security centrally, and they also allow I.T. to install software remotely without visiting branch offices
- **Help desk tools** – These tools streamline the requests coming into I.T. and provide ways to make simple service requests (e.g. password reset) fully automated. These tools also provide valuable information about what service issues are occurring within the employee base.
- **Change management tracking systems** – These systems help credit reporting and audit trails for any changes to systems settings and software releases. This helps improve the overall transparency and security in the I.T. function.

Change #3: Instill a strong business case and project management discipline before technology is purchased – While some degree of creative R&D is helpful in the I.T. function, credit unions simply must become more disciplined in how and when they invest their technology dollars. “I.T. Governance” is a term that refers to how technology initiatives are approved, overseen and prioritized inside the credit union. Even the smallest credit union should have some form of project approval, business case (a one page memo) and prioritization process driven by senior management. The ultimate success factor for any governance process is that choices are made and some I.T. investment requests receive a “No!” answer. Concentrating I.T. spending and staff focus on strategic priorities is a job credit union executive management should take more seriously.

BUILDING AN EFFICIENCY FOCUSED CULTURE

The journey for community credit unions toward greater efficiency will not be easy or completed quickly. Instead, credit union leaders must make great efforts to build a culture that focuses on efficiency.

Again, it takes more than cutting obvious expenses like travel, marketing and charitable donations to become a highly efficient credit union. It takes an environment of continuous process improvement, measurement and accountability.

Leaders hoping to kick off this journey toward best practice efficiency can start in 2010 by:

- **Analyze how your credit union’s overall efficiency compares to peers** – Look at NCUA data and calculate your efficiency ratio to gauge where you are
- **Set ambitious goals for future efficiency** – Create measurements for expense ratios one year, three years and five years from now

- **Benchmark your organization** – The only way to concentrate your efficiency efforts inside the credit union is to know which functions need the greatest focus
- **Assess processes and create improvement plans** – In a brief period of time, credit unions can evaluate their operating processes and involve employees in creating improvement plans. While methodologies such as Six Sigma and Malcolm Baldrige are excellent approaches, most credit unions can get to improving things without these tools or skills. It only takes common sense, a desire to learn new things and focus from senior management.
- **Hold managers accountable for efficiency measurement** – There are simply too many parts of the credit union today where managers do not have measurable goals for efficiency. Scorecards can be effective ways to instill a focus on measurement across all levels of your credit union.
- **Analyze the cost of your branch network** – The branching boom in community credit unions has created many underperforming locations. It’s time to put some real analytics around this area, including branch profitability and staffing measurements.
- **Understand and manage your I.T. costs** – This is the third largest expense in credit unions behind staff and facilities. Monitoring these costs and competitively bidding and negotiating I.T. related contracts for core systems, telecom, Internet banking, bill pay, check processing and credit/debit cards is critical.

CONCLUSION

Community credit unions have an important role to play in the grass-roots of financial services in America. However, the competitive environment after our country’s Great Recession will be one that demands greater strategic focus, discipline and operating efficiencies from these local institutions.

All credit unions interested in living up to their full potential as a not for profit cooperative financial institution need to ensure that efficiency plays a major role in the journey. Leaders need to take the first steps at improving the analytics and discipline around efficiency measurements while instilling an active, accountable culture to pursue efficiency improvements.

There is not one simple move that creates credit union efficiency. Rather, it is hundreds of deliberate and disciplined steps that will separate winners and losers in the new world of financial services.