

# Credit Unions, CUSOs, Collaboration and Capital

**April 2010**  
**NACUSO Annual Meeting**  
**Hot Lunch, Hot Topic...**



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**“The future is already *here*...  
It’s just *unevenly*  
*distributed.*”**

**- Attributed to William Gibson**



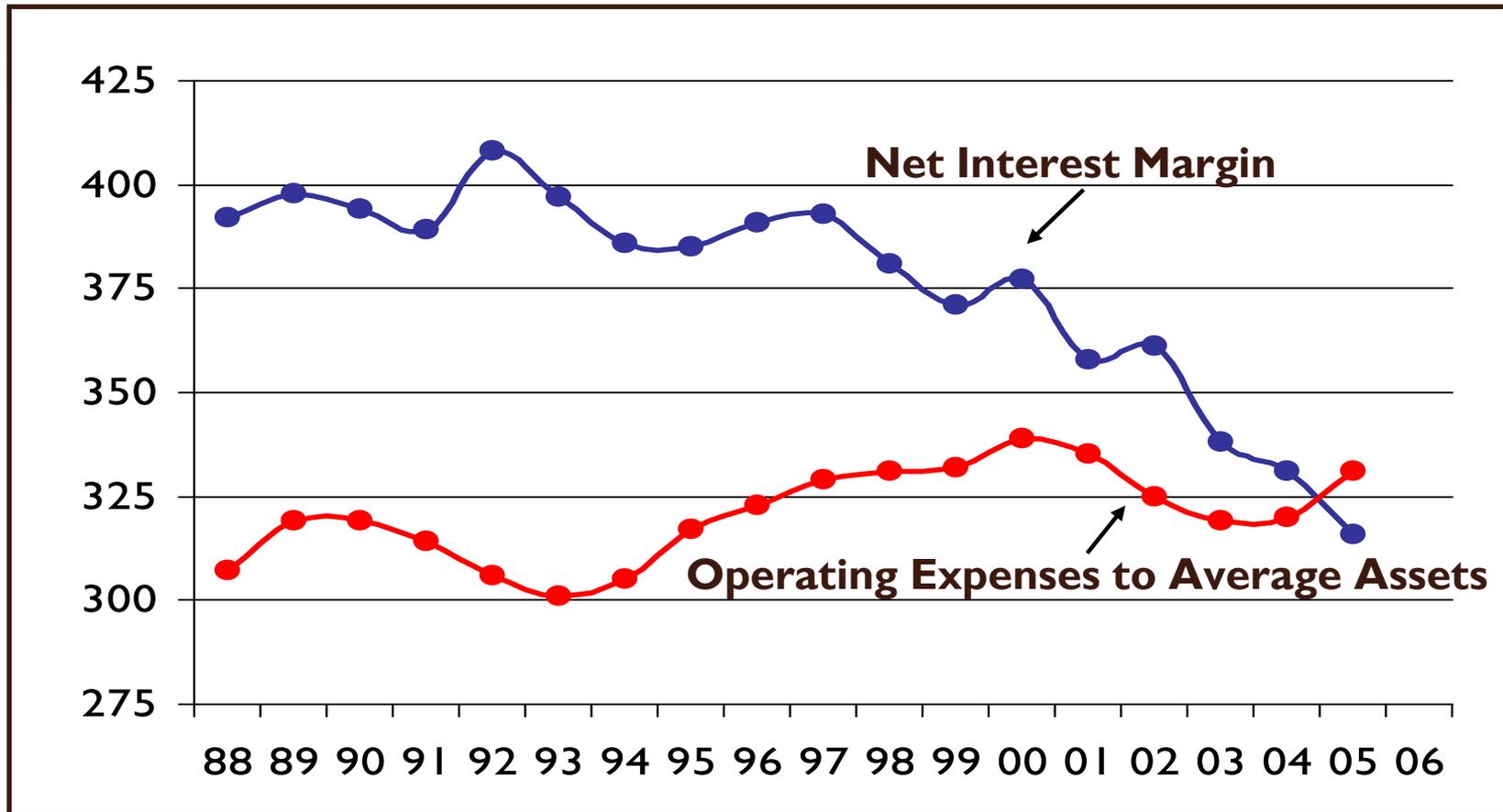
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# Focus Today (other than lunch)...

- Most CUSOs today are focused on operational, technology, investment or mortgage activities
- **Premise: Collaboration will be most beneficial when we can leverage the collective balance sheets of credit unions to benefit consumers (that is to collaborate with capital)**
- Let's spend an hour thinking about the financial aspect of the business and how we can work together...

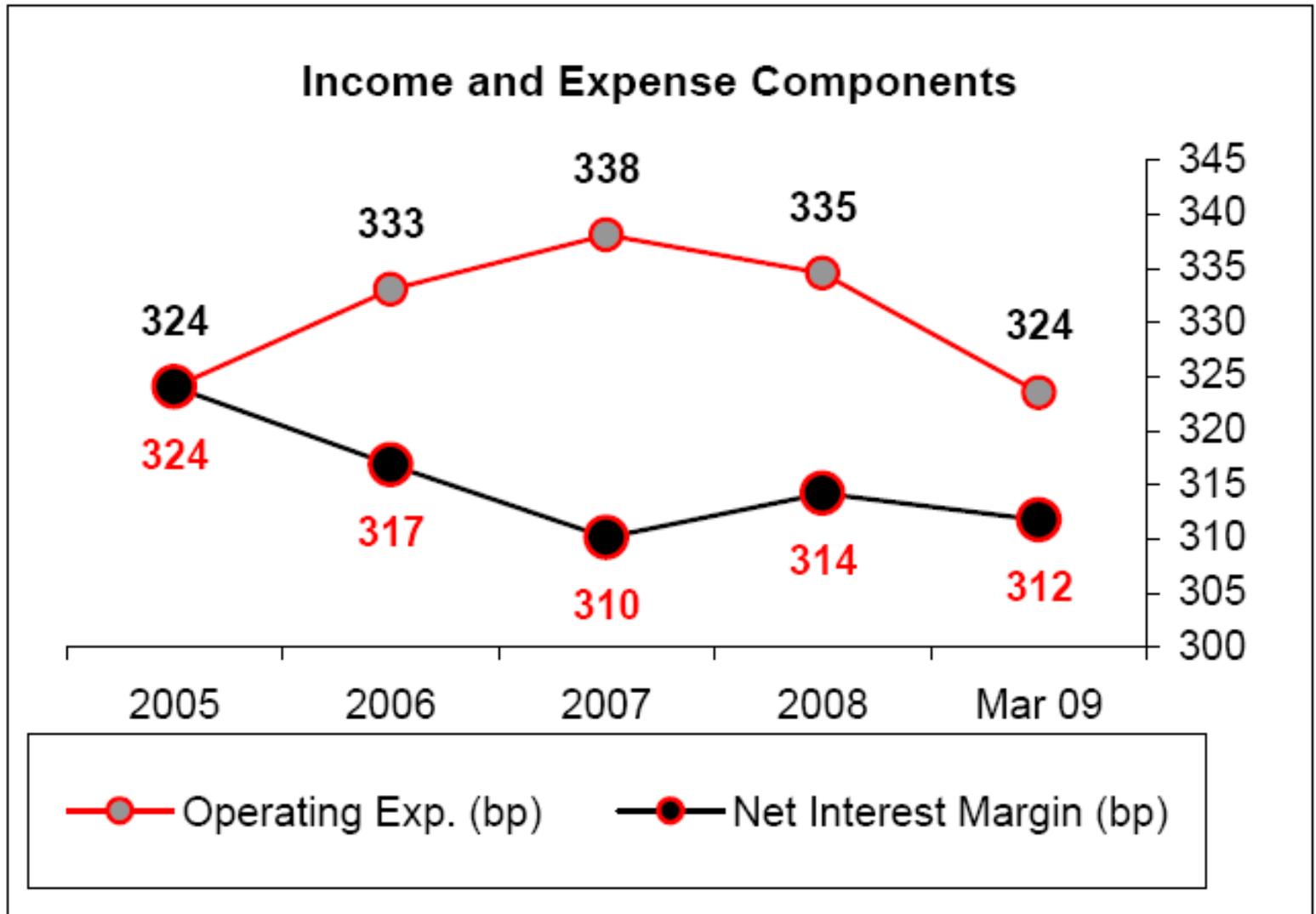


# The Credit Union Death Spiral



Source: CUNA Economics & Statistics and CUNA Mutual Corporate Development  
Slide courtesy of Filene Research Institute

# The Credit Union Death Spiral



Source: CUNA

# Corporate Network Fallout

- Set aside the residual anger for a second...
- Traditional role of Corporate Central Credit Unions
  - Settlement: Move funds for payment systems
  - Liquidity: Short-term loans / short-term deposits
  - Investments: Broker / dealer services
  - Institutional Funding for CUSOs
- A larger impact on collaboration and capital
  - Warehouse line of credit
  - Structured finance
- The future is unclear...
  - Impact of new regulations (part 704)
  - Restrictions on loans and investments



***A note about capital:***

***Not retained earnings***

***Not net surplus (income)***

***Today... a focus from the  
entrepreneurial mindset...***



# Set aside everything you know about capital and business growth

Credit Union Mindset	Entrepreneurial Mindset
Risk is something to be controlled	Risk is something to be explored and exploited
Focus on return on assets (ROA)	Focus on return on equity (ROE)
More capital is better – capital protects against loan losses	Leveraged capital is better – too much capital dilutes return
Capital is generated by retained earnings	Capital is generated through equity investment and net income (over time)
Focus on Spread: Difference between loans and deposits plus fee income	Focus on Margin: How much money is earned by “profitable revenue?”
Business is resource “rich” and can invest where needed	Resources are at a premium and usually are limited – creativity is valued
Percentage growth – 5-7 percent growth is superb!	Magnitude growth – multiple doubling of the business is expected

# Set aside everything you know about capital and business growth

Credit Union Mindset	Entrepreneurial Mindset
Members are the owners – our cooperative governance creates a difference	The credit union, plus entrepreneurs, may be the owners – profit motive by owners creates a difference
Net income is king (access to cash is usually easy – just offer a CD special)	Cash is king (we pay people in cash) <ul style="list-style-type: none"> <li>- More cash is better than less cash</li> <li>- Cash sooner is better than cash later</li> <li>- Less risky cash is better than more risky cash</li> </ul>
Balance sheet and income statement are the most important	Cash flow statement is the most important (although the income statement matters) <ul style="list-style-type: none"> <li>- Many businesses have gone out of business while profitable (ran out of cash)</li> </ul>
Operating expense ratio as defined through regulatory agencies – sometimes more cost is OK to serve members	Understanding of Cost of Goods Sold and maximize efficiency (Revenue – COGS = Gross Margin)

**What if your credit union  
outsourced  
its entire balance sheet?**

**What if all you did was  
member service?**

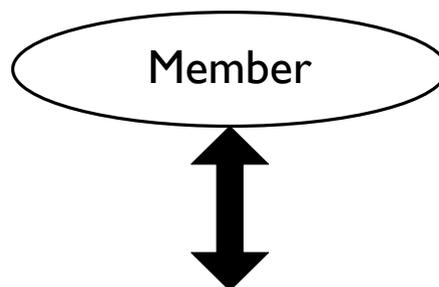


# Principles of a Network Model

1. Ability to move in and out of the network with minimal legal and financial barriers
2. Rules for eligibility to join the network
3. Free sharing of intellectual capital
4. Clear policies and protocols for interacting with the network
5. Credit union shares member information but controls interaction with the member
6. The network does not indemnify the participants
7. Investments remain in the network as long as participants remain a part of the network

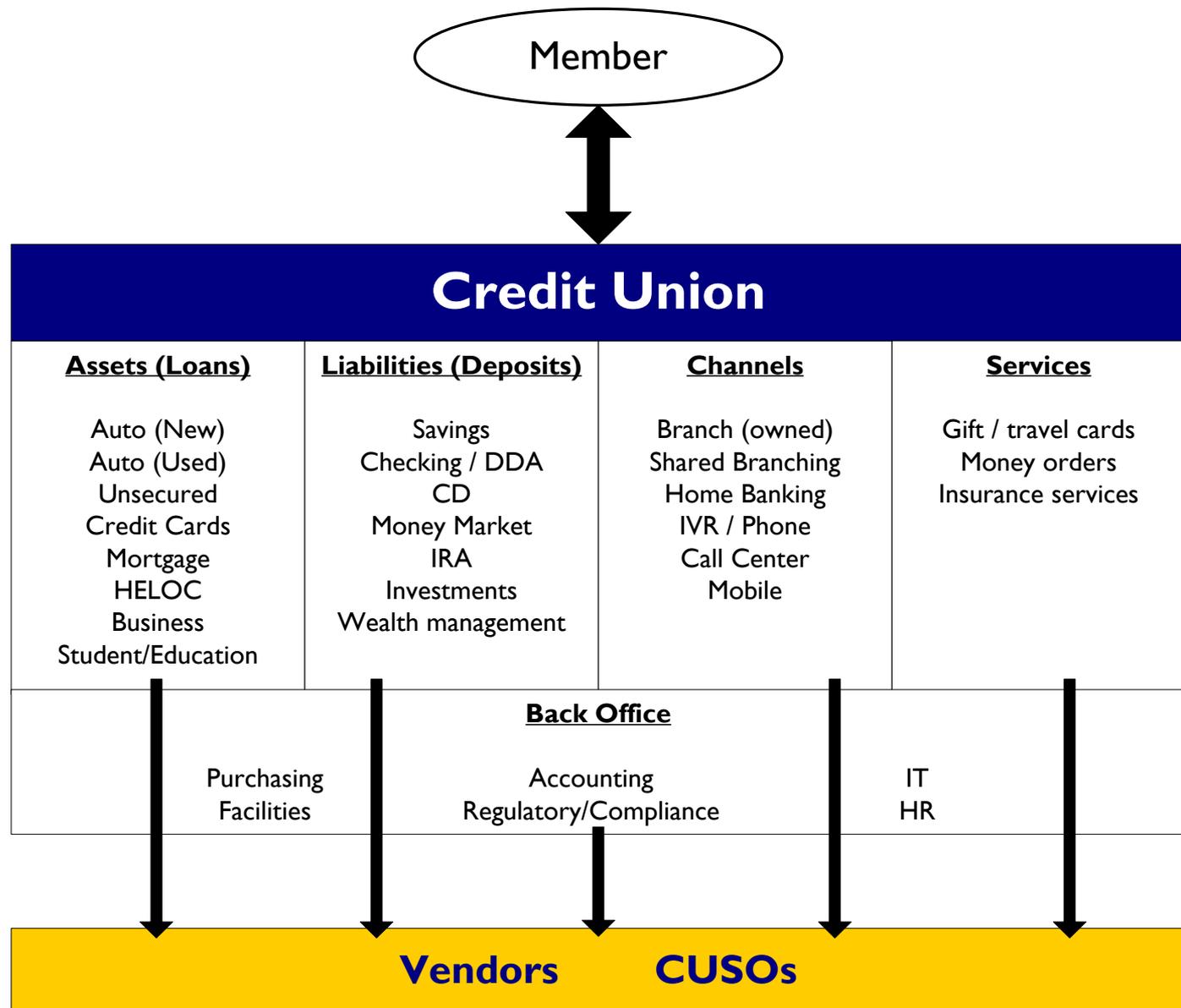


# Traditional Standalone Model

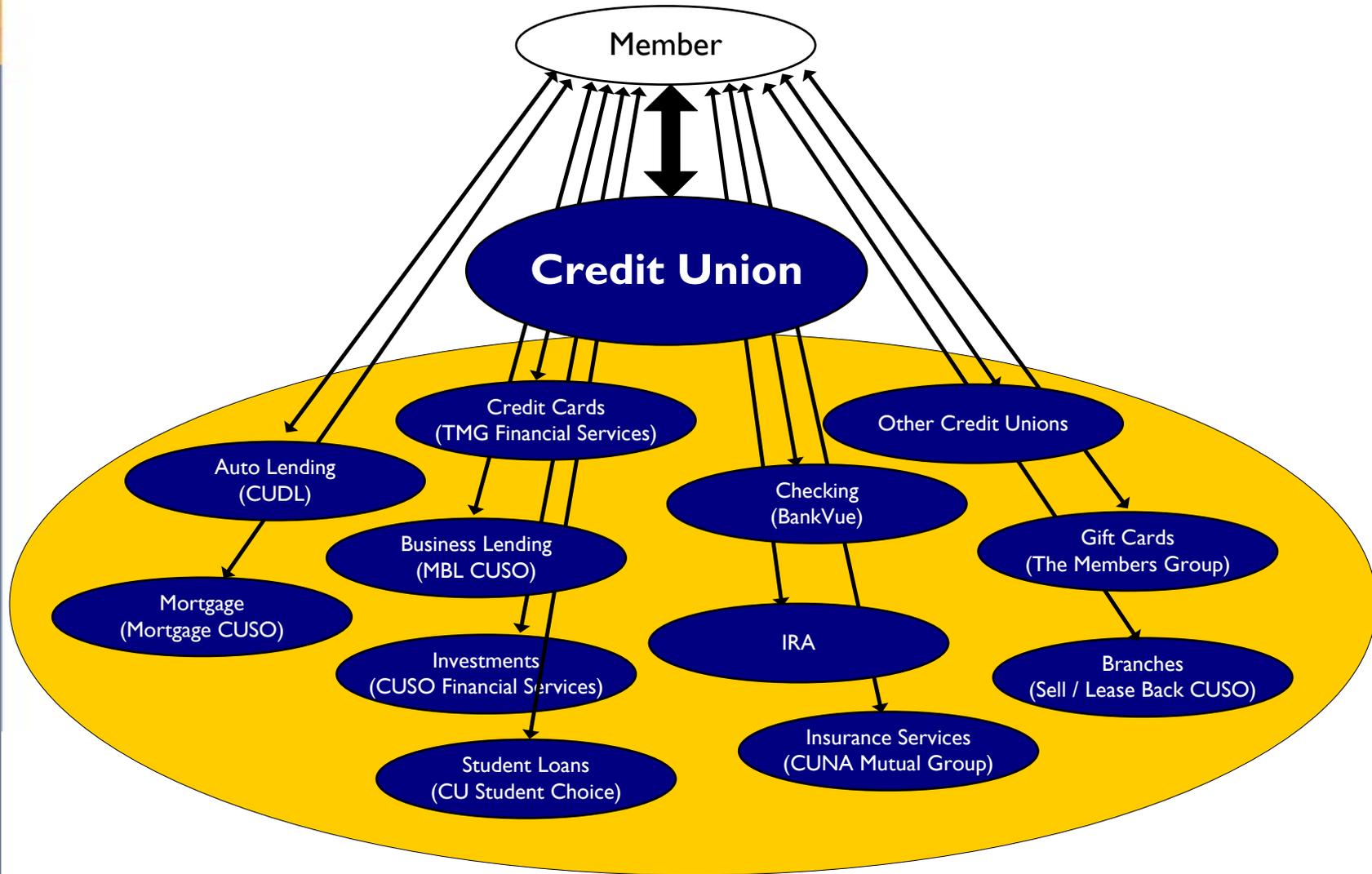


<b>Credit Union</b>			
<b><u>Assets (Loans)</u></b>	<b><u>Liabilities (Deposits)</u></b>	<b><u>Channels</u></b>	<b><u>Services</u></b>
Auto (New) Auto (Used) Unsecured Credit Cards Mortgage HELOC Business Student/Education	Savings Checking / DDA CD Money Market IRA Investments Wealth management	Branch (owned) Shared Branching Home Banking IVR / Phone Call Center Mobile	Gift / travel cards Money orders Insurance services
<b><u>Back Office</u></b>			
Purchasing Facilities	Accounting Regulatory/Compliance	IT HR	

# Formal Collaboration



# Networked Model



# A New Networked Model

- Credit union only performs the services that it can be world-class in delivering
  - Cost/scale/service/quality
- The credit union looks to others to perform any other service for its members that it can't be world class in delivering
  - Other CUSOs
  - Other credit unions
  - Other outside companies
- Those entities interface directly or indirectly with the members in delivering the service, always managing the contact and quality as the credit union would if delivering the service itself (strict SLAs)



# Possible Models

- Franchise Model
  - Common brand, systems, products
  - Individual governance and management
  - Desjardin model in Canada
- “Outsourced Balance Sheet” Model
  - All financial accounts are on another institution’s balance sheet
- Shared Services Model
  - Credit union “hires” the expertise to provide specialized skills – a SVP, Credit Card Lending is a part of the credit union’s management team but works for another entity



# Discussion Questions:

1. Where is our collective future?
  - How can we “share” liquidity / risk in the industry
  - Should we create a venture capital funding structure in the industry?
  - Is there a more efficient way to raise capital? (debt or equity)
  - Could a CUSO “rating agency” help move dollars into the market?
2. Where is the growth funding in our industry? Where are the deep pockets?
  - Traditionally credit unions / CUSOs looked to the Corporate Network for bulk funding
  - What happens after Corporates reorganize? Will they have authority to invest in networked businesses?
3. Are there asset classes that could benefit from collaborative capital structures in the credit union industry?
4. Where do you see the opportunities and challenges for the credit union industry in collaborating with capital in the coming years?
5. Are there any collaborative capital structures that you see as valuable for the entire industry?



# Issues in Capital Today

- “Bulk” Funding: Round up the usual suspects...
  - “Big credit unions:” Current credit union issues, risk-appetite, scarcity of resources
  - Leagues: Often too few resources, many lack entrepreneurial spirit
  - CUNA Mutual Group: Restrictions due to insurance regulations
  - Zombie Corporates?
  - R&D/Angel Funds: Member Gateways, MDC, etc.
  - Filene: Focused today as an “idea factory”



# Issues in Capital Today

- Credit union profitability mentality
  - The difference between profitability (+ \$1) vs. and yielding maximum return for investors. Where is the balance?
  - Benchmarks on profitability – how do I know where I stand against other like businesses?
- Board as a strategic asset rather than a trophy
  - Credit union directors vs. true “entrepreneurial board members”
  - Use of outside directors to increase core competencies and provide different type of feedback



# So Now What?

- A key difference between a credit union-oriented network business and a true “start-up” is the cooperative business model
  - More public companies are looking at a broader “mission” than deliver shareholder value
- Original credit union philosophy: pooling of resources to enter a market that was unavailable to members at the time
- Today: How do we collectively pool capital (both tangible and intangible) to meet the needs of consumers in the next century?
  - Leverage the assets and talent to build new structures to meet members needs



# Reality of Building a Business

- **Plan A:** Well-written business plan, set of detailed pro-formas with a “pile of assumptions”
- **Plan B:** Reaction to the market, change directions based on feedback, re-project assumptions
- **Plan C... ZZ:** Manage the business to the original philosophical objectives and react to changing marketplace conditions, competitive factors and “other news”



# Questions, Comments, Expressions of Hostility?

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