Before the Internet, a prolonged low interest environment and the rise of hundreds of alternative financial service provider competitors, credit unions were able to survive and thrive on the net interest margin, the difference between the amounts earned through interest received on loans and the amount paid on share accounts. The changed marketplace conditions have eroded this model. Add to this, the steep rise in costs in technology, staff and regulatory compliance and one can see why small credit unions are merging out of existence at the rate of 250 to 300 per year.

CUSOs were once an unusual oddity and seldom used. The changes in the marketplace have elevated CUSOs to be a critical part of the credit union system. CUSOs help credit unions save substantial operational costs and add alternative income streams that have enabled credit unions to generate much needed additional net income.

In a Q & A format, we will discuss (1) CUSO Basics in order to understand the structure and regulations pertaining to CUSOs, (2) the history and evolution of CUSOs, (3) the strategic use of CUSOs and (4) a summary of notable CUSOs and their impact upon credit unions.

**CUSO Basics**

**What is a CUSO?**
A CUSO is an organization that is owned by credit unions in whole or in part that provides permitted financial services and/or operational services primarily to credit unions or members of credit unions.

**How are CUSOs structured?**
A CUSO must be a limited liability company, corporation or limited partnership. The corporation can be structured as a for-profit or as a non-profit cooperative. The most common form of CUSO is a limited liability company ("LLC"). CUSOs are typically run by boards appointed or elected by the owner credit unions.

**Who owns CUSOs?**
In order to be called a CUSO, a CUSO must have at least one credit union owner. CUSOs can be wholly owned by one credit union, wholly owned by multiple credit unions, or partially owned by credit unions and non-credit unions. The later occurs when innovators partner with credit unions to offer a service. The staff and directors of the owner credit unions are not permitted to be co-owners of the credit union’s CUSO. Some state credit union rules require that a majority of a CUSO’s owners be credit unions. For federal credit unions and most state chartered credit unions there is no minimum credit union ownership rule.
Statistics show that there is a direct relationship between the size of the credit union and the number of CUSO investments. Large credit unions have more capital and staff expertise to plan and implement CUSO solutions.

CUSOs that provide financial services to members, tend to be owned by one credit union (but not always) while credit unions that provide operational services are almost always owned by multiple credit unions.

Who regulates CUSOs?
CUSOs are not regulated by the National Credit Union Administration ("NCUA"). The Federal Credit Union Act provides the power to federal credit unions to invest and loan to a CUSO but does not give NCUA the power to regulate CUSOs.*

[Federal credit unions may invest] in the shares, stocks, or obligations of any other organization, providing services which are associated with the routine operations of credit unions, up to 1 per centum of the total paid in and unimpaired capital and surplus of the credit union with the approval of the Board: Provided, however, That such authority does not include the power to acquire control directly or indirectly, of another financial institution, nor invest in shares, stocks or obligations of an insurance company, trade association, liquidity facility or any other similar organization, corporation, or association, except as otherwise expressly provided by this chapter.

NCUA has conditioned the ability of federal credit unions to invest in CUSOs by requiring credit unions to obtain the CUSO’s agreement to provide NCUA with access to the CUSO’s books and records. NCUA also requires CUSOs to file certain information with the NCUA on an annual basis. NCUA monitors whether a CUSO is posing any investment or operational risk to the owner and client credit unions. Some state credit union regulators have direct regulatory authority over CUSOs owned by their state chartered credit unions. CUSOs that provide a regulated service are subject to the regulations applicable to that service; e.g. insurance brokers.

What services do CUSOs provide?
CUSOs provide or facilitate financial services to credit union members; e.g., investment and insurance services. CUSOs also provide or facilitate operational services to credit unions; e.g. lending support services, IT services and compliance services. NCUA’s regulation lists the specific services CUSOs may provide.* State chartered credit unions tend to permit the same services and some states have additional permitted services.

Who may a CUSO serve?
CUSOs must primarily serve credit unions or members of credit unions that have a contractual relationship with the CUSO. NCUA’s rules are not specific in how to measure “primarily serves” but by practice it means 51% of the CUSO’s customers must be credit unions or members.
What are the limitations on credit union investments in CUSOs?
Federal credit unions may invest in the aggregate up to 1% of its paid-in and unimpaired capital and surplus in CUSOs. In more understandable terms, it is the shares and undivided earnings of the credit union less reserves. Federal credit unions may loan the same amount in the aggregate. State chartered credit unions often have the same limits but some states allow higher percentage of capital to be invested or loaned to CUSOs.

How many CUSOs exist?
The National Credit Union Administration ("NCUA")* requires CUSOs to make an information filing annually since 2016. The NCUA's CUSO Registry as of 2016 has 974 CUSOs registered. [https://cusoregistry.ncua.gov/Search/Search](https://cusoregistry.ncua.gov/Search/Search)

The National Association of Credit Union Service Organizations ("NACUSO")* has a data base called the CUSO Analyzer. NACUSO’s CUSO count has more recent data. As of 2018, NACUSO lists 1,103 CUSOs, 721 wholly owned and 382 owned by multiple credit unions.

History and Evolution of CUSOs

How do CUSOs fit into the culture of credit unions?
Credit union service organizations facilitate collaboration among credit unions. Collaboration is a cultural attribute of credit unions. Like many cultural attributes, collaboration grew out of necessity. Credit unions began with people associating in their workplace and eventually in small communities. The scale of credit unions was small with very limited resources. Membership overlaps were rare so credit unions were not competing against each other. Credit unions were run by volunteer boards and often volunteer staff. There were no stock incentives to drive personal enrichment. Credit unions could not afford to hire high priced experts to help them. Credit unions helped each other. Cooperation among credit unions is a natural extension of the collaborative model of credit unions themselves. Collaboration is in the DNA of credit unions and became a cultural attribute that fostered a climate for CUSOs to ultimately flourish.

What is the history of CUSOs?

The Early History
The Federal Credit Union Act of 1934 authorized credit unions to invest in organizations which are associated with the routine operations of credit unions. The National Credit Union Administration passed the first CUSO Regulation March 1, 1987 when Ed Callahan was the Chair of NCUA.
Prior to the passage of the CUSO Regulations, some CUSOs existed. Users, Inc. provided data processing services to credit unions. Service Centers, Inc. of Michigan provided shared service centers for credit unions. Both Users and Service Centers were cooperatives owned by credit unions. Users has since dissolved and its assets were sold to FiServ. Service Centers was absorbed into COOP Financial Services another CUSO.

The principal use of CUSOs from 1988 to 1998 was to enable credit unions to receive a share of commission income from broker/dealers in networking arrangements. The Securities and Exchange Commission permits broker/dealers to share commissions with financial institutions where the financial institutions permits the broker/dealer to market its services to the member/customers of the financial institutions. The SEC requires that the broker/dealers have agreements with the financial institutions but permits the broker/dealers to have agreements with service organizations owned by the financial institution if there is a regulatory reason why the financial institution cannot be the party to the agreement. Federal credit unions could only receive cost reimbursements from third parties in these joint marketing arrangements. CUSOs are not regulated by NCUA so this rule did not apply to CUSOs. Credit unions formed CUSOs to contract with the broker/dealers and receive the full commission share.

During this early period, the use of CUSOs for shared operational services was not common. Credit unions were able to manage quite nicely on the net interest margin model, the difference between the interest amount the credit union receives on loans versus what a credit union pays on deposits. Credit unions were not compelled to find less expensive operational services during this time.

Recent History

By 2001, the regulatory climate had changed. NCUA under Dennis Dollar's leadership passed the Incidental Powers Regulation that permitted credit unions to receive full payments for fees paid by third party vendors in joint marketing relationships. With this change, the SEC required that broker/dealers have the networking arrangements directly with the credit unions. CUSOs could be used for investment services if the CUSO itself was a broker/dealer. A handful of CUSOs are registered broker/dealers but most credit unions provide investment service to members through the networking arrangements with a third party broker/dealer. There are two CUSOs that help multiple credit unions work with their affiliated broker/dealers. These CUSOs have expertise in investment services that credit unions typically lack and help the owner credit union owners maximize the impact of investment services for the credit unions.

By 2001, the economic situation was changing as well. Running a successful financial institution was becoming much more expensive. Technology, compliance, and human resources costs started to increase at exponential rates. Since 2001, financial institutions had to develop Internet and mobile delivery channels. After the financial crisis hit in 2008, the historically low interest rate environment put
pressure on the net interest margin model. When loan rates and deposit rates are so close, there is no room for credit unions to thrive, especially with the increase in operational costs. These marketplace pressures continued to cause many smaller credit unions to merge out of existence at the rate of 250 to 300 per year.

If a credit union had operational problems, they could not be solved by a quick capital infusion. They could not raise capital by selling shares. They turned culturally and by necessity to collaboration solutions and CUSOs. To reduce their operational cost and obtain higher levels of expertise, credit unions aggregated necessary back office operations. CUSOs to support lending operations began to appear for mortgage loans, business loans, and managing the dealer network for indirect auto loans. The typical CUSO has less than ten owners but may also serve non-owner credit unions.

CUSOs were formed to provide a wide variety of operational services to reduce costs. Large industry-wide CUSOs grew to serve this need. The big three are PSCU Services, COOP Financial Services and CU Direct. Each of these “Super CUSOs” have made a significant positive impact on credit unions nationwide. Hundreds of other CUSOs provided operational services to smaller groups of credit unions.

**Strategic Use of CUSOs**

**Why do Credit Unions form CUSOs?**
CUSOs help credit unions solve problems and take advantage of opportunities. There are six credit union problems that CUSO help solve.

1. The cost of operations is too high.  
   *CUSOs aggregate certain operational functions so that the cost per credit union is lower.*

2. Higher levels of expertise are needed.  
   *CUSOs aggregate certain operational functions so that credit unions can afford to acquire and retain higher levels of expertise.*

3. Additional income is needed.  
   *CUSOs enable credit unions to generate more net income from loans by increasing lending opportunities and keeping the loan administration costs lower.*  
   *CUSOs generate fee income from third party relationships such as insurance and investment services.*

4. Additional member service options are needed.  
   *CUSOs can help credit unions provide more services to members to compete against other full service financial service providers and better serve their members.*
5. Scale is needed to access key services affordably.

Some third parties are cost prohibitive unless a customer has scale to access their services to negotiate an affordable price.

6. Risk sharing or risk mitigation, especially when developing new technologies or services.

CUSOs spread the risk of developing new tech, products or services across several credit unions that are owners in, or clients of, the CUSO.

CUSOs providing operational services have demonstrated the ability to save credit unions millions of dollars of operating costs while increasing the level of the services provided. CUSOs providing operational services have demonstrated the ability to earn their credit union owners and clients millions of dollars in additional net income.

How do CUSOs generate fee income?

Interest income alone is often not enough to keep credit unions healthy. Credit unions have turned to fee income as an additional revenue source. Some credit unions began to rely heavily upon interchange fees, overdraft fees (euphemistically called “courtesy pay” by some credit unions) and other fees, usually to members who can least afford them. These credit unions were impacted when regulators cut back the ability for credit unions to charge these types of fees.

CUSOs facilitate the generation of positive fee income, fees for services of value to members such as a share of commissions for the sale of insurance and investment products. The member gets a valuable product that the member chose and the commissions are no more then if the credit union did not take a portion of the commissions. This type of fee does not “punish” the member and is not likely to be banned by a regulator in the future.

How do CUSOs provide the means to deal with emerging challenges and opportunities?

CUSOs enable credit unions to bind together to tackle big emerging challenges. On Approach and Denali Analytics are CUSOs formed to help credit unions gather, collect, analyze and use big data on an affordable basis. The ability to use Big Data to make service and lending decisions is a game changer for financial institutions and credit unions cannot afford to be left behind. CU Ledger is a CUSO formed to develop block chain technology for credit unions that will provide the highest level of security for online transactions; another key tool for successful financial institutions. Even large credit unions would not have the ability to tackle these issues by themselves.

How do CUSOs provide affordable access to key services?

I can best explain this concept by example. The company Satmetrix provides valuable feedback to credit unions on member attitudes and behavior through its
net promoter score tool. The price for this service is quite high. Credit unions formed the CUSO Member Loyalty which negotiates affordable terms for the credit unions to use the tool.

The ability of operational services CUSOs to negotiate better terms with their vendors have proven to be very effective. By combining the scale of the owner credit unions prices can drop dramatically.

Are there CUSOs that provide comprehensive back office support to credit unions? While most CUSOs are service specific and provide one, two or three services, a handful of CUSOs are deep dives into a coordinated back office operations. The most ambitious CUSOs are the CUSO duo Open Technology Solutions (“OTS”) and Shared Services Solutions. (“S3”). Both CUSOs are owned by three large credit unions, Bellco Credit Union, State Employees of Maryland Credit Union and Bethpage Federal Credit Union. OTS provides technology support services support for the owner credit unions and manages the relationship with the common core IT provider DNA from FiServ. S3 provides or coordinates a wide number of services for the owner credit unions including mortgage lending, collections, loan analytics, business continuity and disaster recovery.

What are the lessons learned by the extensive collaborations? First that scale alone is not enough. Credit unions can customize their forward facing member relationships but the back office must run as one collective credit union if the credit unions make the changes necessary to enjoy the full benefits of the collaboration. The credit unions have to use common policies, common lending documents, and common procedures. A successful back office collaboration has to work as one system behind the scenes. Credit unions seeking special treatment are an impediment to a collaboration’s effectiveness.

The second lesson is do not fall in love with a vendor. The top three vendors in a chosen service are all usually qualified and while their respective bells and whistles may not be the same, all three vendors can provide the needed service. Vendors should be selected solely based on the value of the service in relationship to the price. There should be one vendor per service.

The third lesson is that regulations may require you to modify the business model. For example, if a CUSO would require a license in every state to provide a needed service, it might be better to use a credit union’s Incidental Powers to provide that service instead.

The fourth lesson is that a collaboration is a relationship not a transaction. Some of the most successful CUSOs start out with the phrase, “We really need to do this and we will figure it out as we go.” The credit union owners of OTS and S3 knew that they needed much more scale to compete against the giants in the financial industry. They had sound ideas of what they needed to do it and had a plan but the plan is constantly changing as circumstances change. Flexibility for CUSOs and
collaboration is essential. The reason why OTS and S3 are successful is that you have three credit union CEO’s who do not make any key decision without contemplating the impact of the decision upon the other credit union partners and encouraging a collaborative solution when possible.

How do credit unions and CUSOs work with individual innovators?
CUSOs can provide the structure for individual innovators to work with credit unions. Member Gateways was a CUSO owned by about 24 large credit unions that often connected individual entrepreneurs with credit unions through a CUSO. Member Gateways was a think tank and angel investors for new ideas to enable credit unions to effectively bring new services to members. It was started by credit union CEOs seeking to solve problems and create new opportunities collectively. The CUSO worked very well as long as the CEO’s were involved with that attitude.

The first project Member Gateways undertook was to develop a service with American Express that did a sweep of member investment accounts and pay overnight fund rates. After spending one million dollars that service did not work out. Rather than call it quits, the credit union CEO’s took the attitude that not all ventures will work out but the loss is spread over many credit unions and they learned some lessons from the experience. Member Gateways went on to invest in some very successful CUSOs. Many CUSOs were with non-credit union partners, including, CUSO Financial Services (broker/dealer), CU Realty Services (real estate brokerage services that drives mortgage loans to credit unions) and Gateway Services (insurance and investment program management). Member Gateways disbanded after 15 years. The reason is that the CEOs who formed Member Gateways ceased to be personally involved and it transitioned from a problem solving forum for the CEOs to a place just to see the next services someone wanted to offer. The lesson is that strategic CUSOs work only when there are engaged CEOs that identify and work on solutions to common issues.

Is there a trade association for CUSOs and credit unions forming CUSOs?
Of course, we are talking about credit unions who love trade associations. The National Association of Credit Union Service Organizations ("NACUSO") www.nacuso.org was formed in 1987 to provide education and networking opportunities to help credit unions understand how to form and use CUSOs. As with most organizations, it started small. In the beginning, the conferences were dominated by investment services as that was the principal reason to form a CUSO.

As the industry changed, NACUSO changed. Now it is a multi-dimensional organization. There are advisory committees and education tracks at its Annual Conference to cover the wide spectrum of services CUSOs offer. NACUSO sponsors the Next Big Idea Competition to communicate innovative ideas to credit unions and facilities the networking to connect credit unions, CUSOs and individual innovators to develop successful collaborations. NACUSO is active as an advocate before NCUA and Congress on issues affecting CUSOs and credit unions that use CUSOs. The mission of NACUSO is to advocate for and protect a favorable regulatory climate for
credit union collaboration in order to protect the ability of CUSOs to be the gateway for innovation in the credit union world. The world has changed and credit unions have to move quickly to meet the challenges. Forward thinking credit unions use CUSOs to help create and manage the necessary changes.

The board of directors of NACUSO are CUSO executives and credit union CEOs. Jack Antonini is the president of NACUSO. Prior to joining NACUSO, Jack was CEO of the USAA Federal Savings Bank and President and CEO of Cardtronics.

What keeps credit unions from using CUSOs more?
Obstacles exist to the formation and use of CUSOs, especially CUSOs that provide critical operational services. Lack of time, lack of resources, and lack of vision all are obstacles, especially for smaller credit unions. There are also the emotional barriers, the fear of a CEO or credit union board to make dramatic changes, the fear of relying upon a partnership instead of an internal chain of command, and the threat to the ego of permitting others to co-manage the credit union. Successful collaborations are hard work and can be difficult even for those with the best intentions. For those who are willing to work through the obstacles, there are tangible ongoing benefits that can make the participating credit union much more competitive and financially sound.
A Summary of Notable CUSOs

CU Answers, Inc.

Services: Core IT services technology and operational support services for credit unions
Ownership: 128 credit union owners
Clients: 182 credit unions
Formation: 1970
Location: Grand Rapids, Michigan

Services
The original purpose of CU*Answers was to aggregate expertise and reduce costs of supporting third party core processing services. The CUSO developed its own core processing software called CU*Base. The services offered have evolved over time as new technologies have been introduced, but the mission to provide data processing services at a disruptive price remain both at CU*Answers and its affiliated organizations.

CU*Answers affiliated CUSO, Xtend provides the following services: bookkeeping, mortgage services, disaster recovery, business continuity, strategic planning, call center (both incoming and outgoing services), shared branching within the CU*Base network, forms exchange, member texting communications, conversion support, 5300 call report preparation and cooperative liquidity (through loan participations and certificates of deposit sales). Through AuditLink, Xtend formed a relationship with Trust Exchange to offer credit unions a comprehensive vendor management program.

While CU*Answers provides technical solutions in many of its services, there is equal emphasis on the relationship solutions; services that impact the relationship of the credit union to its members and the relationship between credit unions to enhance the ability of credit unions to serve members.

History and Structure
CU Answers began as a service of Grand Rapids Teachers Credit Union. The credit union provided support to credit unions running a Fiserv core processing product. When Grand Rapids Teachers Credit Union requested capital to continue to provide the services, the credit union clients and Grand Rapids Teachers Credit Union decided to form a CUSO.

West Michigan Computer Co-Op, Inc. (WESCO) was organized as a non-stock cooperative to provide low-cost data processing service for credit unions. It initially had nine board members and approximately five staff members. All clients but one was on the Fiserv core IT platform. In 2003, WESCO changed its name to CU*Answers, to reflect that the CUSO was serving the broader credit union industry.
From the beginning, the CU*Answers choose a cooperative model, one owner-one vote no matter what the size of the owner. The model is a carbon copy of the credit union model. Grand Rapids Teachers Credit Union saw the value in this model versus having unequal ownership rights based on the size of the owner or whether the owner was a founding owner.

Originally the CUSO was organized as a corporate non-stock entity with nine board members. In 1985, the CUSO was reorganized as a corporate stock cooperative. All credit union owners have to be on the CU*Base platform. In 1990 the board of directors was reorganized to seven members comprised of the CEOs of credit union owners that have been owners for a minimum of one year. The directors are elected by the owners and serve three year terms.

CU*Answers has also expanded its reach through investments in other organizations. In 2002 CU*Answers formed Xtend, Inc., a cooperative CUSO that provides a wide variety of services focusing on four main objectives: communication, collaboration, connection, and execution. The goal in creating a separate CUSO to provide these non-IT services was to broaden the clients served. Credit unions do not have to use CU*Base to participate as an owner or client of Xtend. Xtend invites all credit unions to avail themselves of the advantages of collaboration; i.e. market disruption through lower prices, access to new markets and the advantages of shared execution of common functions. Shared execution overcomes the problem that a credit union may have the tools but not the time to use them. Xtend is owned by 83 credit unions and CU*Answers.

While CU*Answers has a national footprint of clients, its Board challenged the management team of CU*Answers to walk its talk and engage in cooperative relationships with other CUSOs instead of engaging in a nationwide acquisition strategy. CU*Answers saw the advantages of working with CUSOs with a strong local commitment to their credit unions and affiliated with three organizations serving credit unions on the CU*Base platform: CU*South in Alabama, CU*Northwest in Washington State and Site-Four in South Dakota. CU*Northwest and Site-Four are CUSOs that are co-owned by CU*Answers.

Both CU*Answers and CU*Northwest are winners of NACUSO's CUSO of the Year Award.

Credit Union Impact
CU*Answers has a unique investment and funding structure. There are four means of returning value to the owners. As all owners must use CU*Base, the first return is to have higher levels of expertise in IT support services at a lower cost than the credit unions could afford individually. The three other methods or returning value are actual payments made to the owners.

As a corporate cooperative in Michigan, CU*Answers pays a stock dividend and every owner gets the same amount (historically between 4% and 8% of the
This insures all owners receive value just for being and owner and investing in CU*Answers. CU*Answers also pays a patronage dividend that correlates with the amount of direct business (revenue) done with the CUSO. The patronage dividend rewards the heavy users of CU*Answers’ services. Note that CU*Answers does not discount fees to owners so volume discount are recognized through patronage dividends. The final value return is through the use of debentures. If CU*Answers has a project that it wants to develop it often issues debentures to finance the projects with interest returns that are slightly above market rates. This encourages an available stream of capital and provides another tangible benefit to the owners. CU*Answers finds that it has to ration the debenture offering to be sure all those interested have an opportunity to participate.

As to the stock price, each year the board of directors establishes the purchase price for stock after considering the CPA audit. The investment amount for a new owner runs between 2% and 2 ½% of book value. The method of valuing the shares, encourages the owners to build the company and increase the equity and share value. CU*Answers has never had to re-capitalized in their 46 plus year history.

If an owner no longer is on CU*Base, it must leave the CU*Answers. The owner is paid the book value of its shares. The stock cannot be sold by the owner other than back to CU*Answers.

Rather than organize as a limited liability company with pass through tax liability to the owners, CU Answers organized as a corporate cooperative and by doing so shielded the credit union owners from any income tax liability issues.

Lessons Learned

Ownership and alignment are the keys to success. The credit union owners decide the CUSO’s priorities. If there are service issues, the owner/users solve them. CU*Answers is the tool of the credit union owners that collectively succeed by executing the credit unions’ agenda and not an organization that provides useful services to credit unions. The difference sounds subtle but it is not. The long term success of CUSOs depends upon a system that is implementing solutions to problems identified and driven by credit unions. If credit unions cease to see the CUSO has their tool to solve their problems, the CUSO becomes just another vendor pushing a solution that may or may not be relevant to the credit unions.

CU Answers lives by the seven cooperative principals: (1) Voluntary and Open Membership; (2) Democratic Member Control; (3) Members’ Economic Participation; (4) Autonomy and Independence; (5) Education, Training and Information; (6) Cooperation among Cooperatives; and (7) Concern for Community. CU*Answers has created video and educational pieces to promote the cooperative model. By aligning the CUSO structure with the credit union structure, conflict is reduced. CU*Answers believes that the cooperative model is powerful and should be celebrated. No one should feel like a cooperative is a second class citizen to the for-profit world.

By working with other CUSOs, CU*Answers assembled a culture of mission aligned people with diverse opinions and talents. CU*Answers learned that aggregation of effort was very effective while the path of consolidating in one organization
destroys the culture of the acquired organization without benefiting the member. Aggregation of CUSOs is aligning strengths and building a broader base and this is in line with the seven cooperative principles. CU*Answers recognizes the concept of enlightened self-interest and works with it, not against it. People and credit unions want to be successful and unless the CUSO is helping them do that the CUSO will fail. Collaborations built only on feel good altruism will not work in the long run. The CUSO must demonstrate tangible financial and operational returns to the credit unions and the CUSO employees to be successful.

CU*Answers is more focused on creating an income statement than a balance sheet. It’s a slow build, but so are credit unions. The power of collaboration is the ability to create collaborative disruption through 1) pricing, 2) market access, or 3) shared execution. If a credit union owns the solution, it will never be at odds with the strategic direction of the credit union. So the build solution is favored over the buy solution.