

The Comprehensive Guide to Credit Union Performance Benchmarking

Do's, Don'ts, and Must Know Metrics for C-Suite Executives

CALLAHAN
& ASSOCIATES
the credit union company



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WHY SHOULD I READ THE COMPREHENSIVE GUIDE TO CREDIT UNION PERFORMANCE BENCHMARKING?

A credit union's current and historical performance help shape the direction its leadership takes the cooperative in the future, making any miscalculations potentially harmful down the line.

The most powerful way to ensure you're getting an accurate read of where your credit union stands in key areas is by benchmarking performance against relevant peers. Although it sounds simple enough, it takes a bit of know-how to realize benchmarking's full benefits.

This guide will help grow your understanding of credit union performance benchmarking by exploring the concept in-depth, showcasing the metrics executives in each key department should be looking for, and supplying best practices. With accurate benchmarking, you'll be able to make stronger strategic decisions that help your institution achieve its goals, whatever those may be.

What you'll find in the guide:

- A formal benchmarking definition and why it's beneficial
- Key metrics for the CEO, CFO, COO, CLO, CMO, and HR head
- Industry averages for key benchmarks
- Common benchmarking pitfalls to avoid
- A breakdown of various benchmarking methods

Whether you're new to performance benchmarking or are looking for ways to optimize your current efforts, *The Comprehensive Guide to Credit Union Performance Benchmarking* will get you on the way toward accurately measuring your credit union's performance.



WHAT IS BENCHMARKING?

Benchmarking is the interpretation and analysis of financial information in order to make direct performance comparisons to other credit unions, banks, and customized groups of peers. It enables a credit union to track internal goals, identify opportunities, reinforce strengths, and reveal weaknesses.

WHY SHOULD I BENCHMARK?

Without accurate and detailed knowledge of your credit union's competition it's impossible to properly gauge performance in key areas. Benchmarking shows where you need to make changes and the areas you can build upon. Basically, it provides the numbers to back up (or disprove) your assumptions.

At a more granular level, benchmarking also helps you:

- Gain a better understanding of your market
- Monitor progress towards specific goals
- Identify potential performance pitfalls
- Understand and spot patterns
- Provide actionable and meaningful information to your team
- Reduce the likelihood of decisions being made for intuitive or emotional reasons
- Review operations at a high-level

If done regularly, benchmarking can have a direct impact on the bottom line. Unfortunately, it used to be an involved process reserved only for those with the most advanced financial knowledge. For instance, benchmarking against a local bank involved rectifying differences between the NCUA and FDIC call reports. Thankfully, there are now tools available that do this sort of work for you and make all the necessary data easily accessible.

It's now possible for credit union professionals across all departments to use benchmarking for conducting data-backed performance analysis. The key is knowing what metrics to look for.



KEY BENCHMARKING METRICS BY ROLE

For credit union executives, being familiar with a range of relevant performance ratios is the first step toward successful benchmarking, but understanding the factors that influence each ratio and the potential drawbacks of using one over the other is equally critical.

Historically, benchmarking was limited to CEOs and CFOs, but it can and should be performed by all C-suite executives. Similar to tracking your departmental budget, you should be aware of how your team's efforts are impacting the credit union. With that foundational information, you can choose the best strategy moving forward.

The following pages outline and contextualize key benchmarks for several high-level positions commonly seen at credit unions.

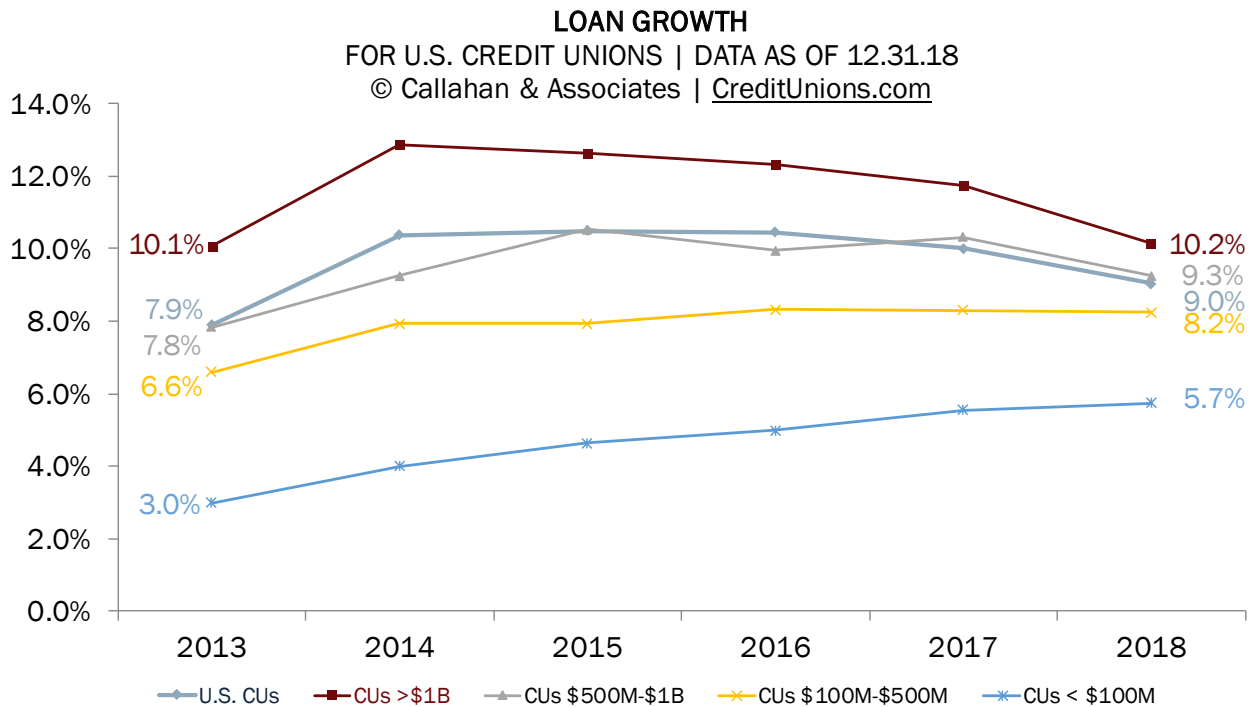
Chief Executive Officer

LOAN GROWTH

Definition: Loan growth is calculated as the period-to-period change of loans outstanding.

National average (as of year-end 2018): 9.0%

$$\frac{(\$) \text{ Loans Outstanding Current Period}}{(\$) \text{ Loans Outstanding Prev. Period}} - 1$$



Loan growth is driven by several factors, including the state of the economy, membership demographics, the level of risk the credit union is willing to manage, and the credit union’s ability to gain market share.

The overall market for loans is influenced by the membership’s confidence in their ability to manage debt. The demographic factors that influence loan growth include the number of borrowing age members, how affluent the membership is, and their cultural attitudes towards debt and borrowing. Finally, the credit union’s ability to penetrate its potential loan market through marketing, product development, sales culture development, and the use of multiple delivery channels are all reflected in this ratio.

SHARE GROWTH

Definition: Share growth is calculated as the period-to-period change of total share balances.
National average (as of year-end 2018): 5.2%

$$\frac{(\$) \text{ Share Deposits Current Period}}{(\$) \text{ Share Deposits Prev. Period}} - 1$$

Share growth is driven by several factors, including the state of the economy, membership socio-economic status, and the credit union’s ability to pay market rates and gain market share. This is an important ratio to monitor in relation to the credit union’s efforts to market its deposit products.

ASSET GROWTH

Definition: Asset growth is calculated as the period-to-period change of total assets.
National average (as of year-end 2018): 5.4%

$$\frac{(\$) \text{ Total Assets Current Period}}{(\$) \text{ Total Assets Prev. Period}} - 1$$

A credit union’s asset growth is affected by both internal and external factors. The external factors include the state of the economy and the make-up and size of the credit union’s field of membership. The internal factors include the quality of member service, the menu of products available, and the credit union’s pricing philosophy.

MEMBER GROWTH

Definition: Member growth is calculated as the period-to-period change of total members.
National average (as of year-end 2018): 4.4%

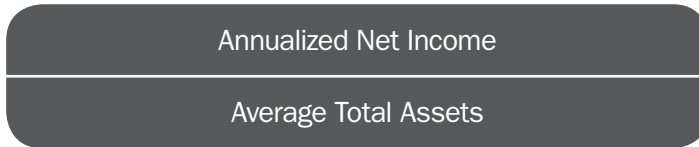
$$\frac{(\$) \# \text{ of Members Current Period}}{(\$) \# \text{ of Members Prev. Period}} - 1$$

Member growth is the result of implementing effective business strategies in the credit union’s market place. Member growth strategies are driven by the board’s philosophy towards service levels, delivery channels, product pricing, and breadth of services offered.

ROA

Definition: Return on assets (ROA) is calculated by dividing annualized net income by average total assets.

National average (as of year-end 2018): 0.92%



ROA is an important gauge of a credit union's profitability. It shows how efficiently management is running the credit union by revealing how much income is generated for each dollar of assets deployed.

In general, a high ROA relative to peers reflects management's success at utilizing its assets to generate income. Credit unions; however, should view ROA in light of their institution's distinct strategy. For example, if a credit union passes along potential profits to members (e.g., no fees, high deposit rates, low lending rates), then its strategy might result in a lower ROA relative to its peers.

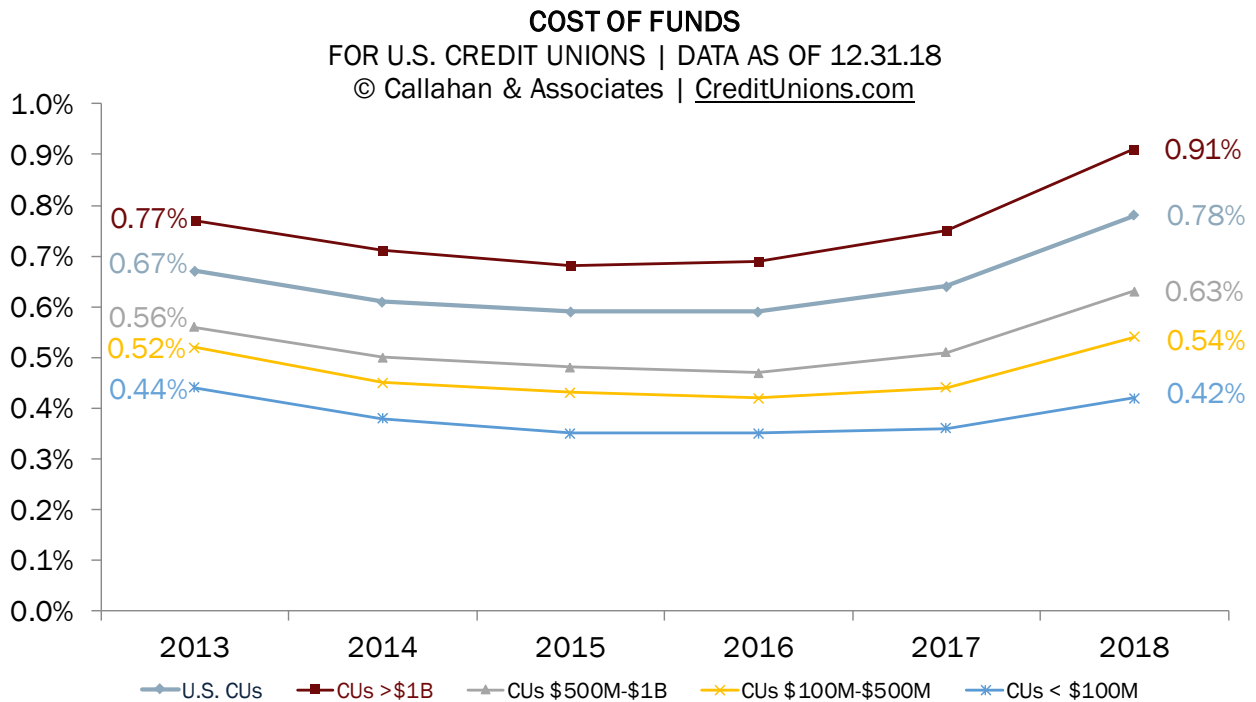
Chief Financial Officer

COST OF FUNDS

Definition: Cost of funds is calculated as the dividends paid to members and interest paid on borrowed money, divided by the average outstanding shares and borrowings.

National average (as of year-end 2018): 0.78%

$$\frac{\text{(Dividends on Shares + Interest on Deposits + Interest on Borrowed Money)}}{\text{((\$) Total Shares + (\$) Total Borrowings)}}$$



A credit union's cost of funds is influenced externally by the overall rate environment and internally by the make-up of the deposit portfolio. For example, older members might have more CDs, or a more affluent membership might have higher balances on tier-priced products. Both situations will increase the cost of funds. Credit unions with high checking account penetration will generally have lower cost of funds. When interpreting the cost of funds, it is easy to think about it as how much the credit union must pay in interest for every dollar of shares or borrowings it receives.

CAPITAL RATIO

Definition: The capital ratio is calculated by dividing total capital by total assets.

National average (as of year-end 2018): 11.6%

$$\frac{\text{Capital}}{\text{Total Assets}}$$

This measure evaluates what percentage of a credit union’s assets are backed by capital. While this ratio should not get too low, a very high percentage indicates that a credit union may not be using its assets productively. The capital ratio is a liquidity measure and should be monitored in conjunction with a credit union’s ALM strategy.

Note: the capital ratio and net worth ratio are two distinct measures even though they are often referred to interchangeably. The capital ratio specifically includes allowance for loan and lease losses whereas the net worth does not.

NON-INTEREST INCOME/AVERAGE ASSETS

Definition: This measure is calculated by dividing the sum of annualized fee and other operating income by average total assets.

National average (as of year-end 2018): 1.4%

$$\frac{\text{Annualized Fee Income} + \text{Annualized Other Operating Income}}{\text{Average Total Assets}}$$

This ratio measures the amount of non-interest income the credit union generates as a percentage of average assets. The higher the number, the more income is being generated by sources other than asset-based products.

Analyzing non-interest income as a percentage of assets removes the variations that exist when comparing the ratio to total income (e.g., viewing by assets removes the impact of a weak loan-to-asset ratio). Non-interest income factors that impact the ratio generally fall into two major categories, income generated directly from the member in the form of fees and income generated indirectly from members or other aspects of the credit union’s operations (e.g., interchange income from credit and check cards and income from CUSO activity). The rate of asset growth is the most impactful variable on the ratio, although strategies for non-interest income play a part as well. Rapid asset growth will depress the ratio while slow or stagnant asset growth will inflate the ratio.

NET INTEREST MARGIN

Definition: The net interest margin is calculated by subtracting dividends paid to members from the interest income from loans and investments, then dividing that figure by average total assets.

National average (as of year-end 2018): 3.13%

$$\frac{\text{Interest Income – Dividends Paid}}{\text{Average Total Assets}}$$

The measure is the result of the organization’s execution of its lending, investing, and liquidity strategies. The credit union’s ability to manage its spread is a critical component in managing this metric. For example, appropriately pricing loan products (via risk-priced loans) or deposit products (through a clear differentiation between rate sensitive and non-rate sensitive products) significantly enhances the organization’s flexibility in managing the margin.

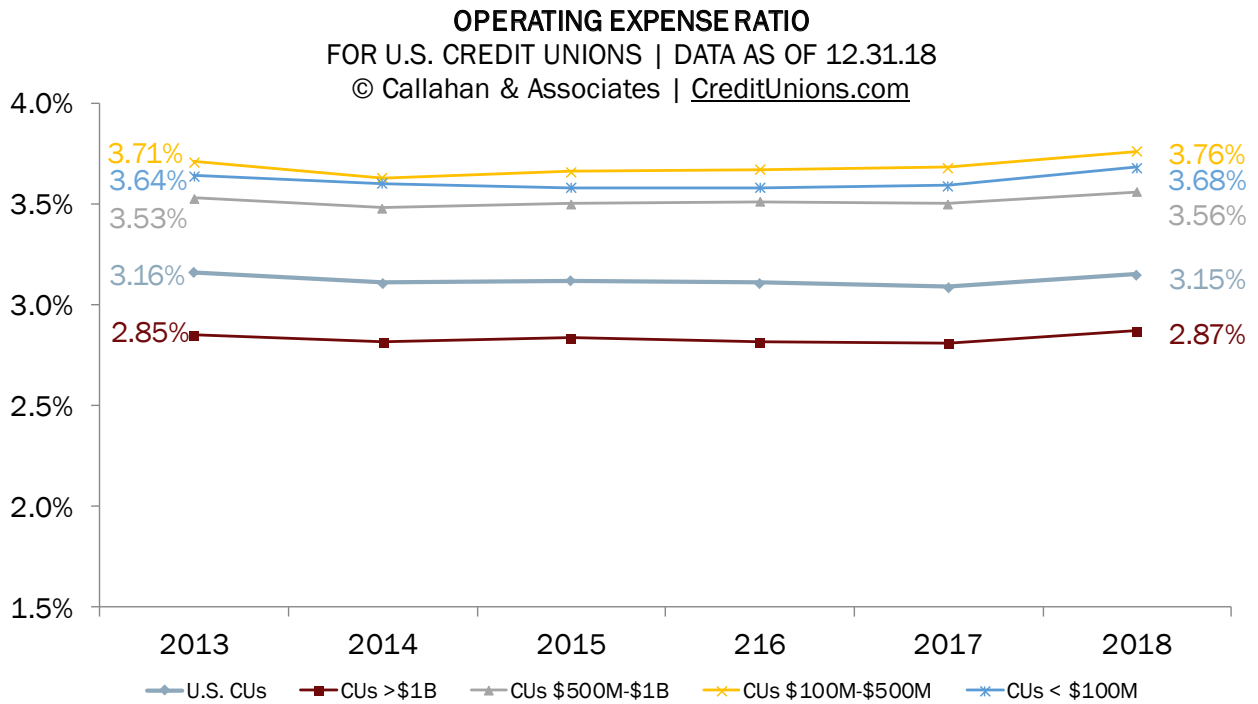
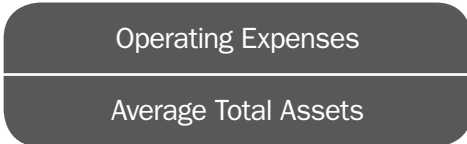
Credit unions with lower operating expense levels or strong non-interest income will be able to sustain more competitive loan and deposit pricing strategies. Credit unions with higher expenses, loan losses, or lower non-interest income levels will need to maintain higher net interest margins.

Chief Operating Officer

OPERATING EXPENSE RATIO

Definition: This measure is calculated by dividing operating expenses by average total assets.

National average (as of year-end 2018): 3.15%



The operating expense ratio reflects both the operating efficiency and the operating strategy of a credit union. The breadth of a credit union’s product and service line will also have an impact on this ratio.

Managing expenses more efficiently can have a significant impact on a credit union’s competitiveness and the value it creates for members. In comparing expenses to assets, this ratio underscores the idea that a larger balance sheet is a result of a larger operation that requires greater resources. The ratio can be compared to the operating expense to income ratio, which can show larger swings due to the impact of interest rate changes on total income.

OPERATING EXPENSE TO INCOME

Definition: This metric is calculated by dividing the credit union’s operating expenses by total income.
National average (as of year-end 2018): 60.6%

$$\frac{\text{Operating Expenses}}{\text{Total Income}}$$

Credit unions that pursue a full service strategy with a diverse product portfolio will generally have higher expense levels than credit unions with more limited offerings. The credit union’s expense to income ratio depends on its ability to generate income from those products and services. The ratio is also a measure of credit union productivity. Investments in technology can boost productivity and lower expenses when managed successfully. Product-pricing strategies also have a significant impact on the ratio. Credit unions that price products and services competitively generally have a solid expense to income ratio.

EFFICIENCY RATIO

Definition: The efficiency ratio divides a credit union’s operating expenses by interest income less interest expenses plus non-interest income.
National average (as of year-end 2018): 69.9%

$$\frac{\text{Operating Expenses}}{\text{Interest Income} - \text{Interest Expenses} + \text{NII}}$$

The lower the efficiency ratio, the better. A high or rising efficiency ratio means that the credit union is losing a larger share of its income to overhead expenses. A low efficiency ratio means that operating expenses are a smaller percentage of income. In general terms, the efficiency ratio can be interpreted as how much does it cost the credit union to create \$1 of revenue. The efficiency ratio can fluctuate over time, influenced by the interest rate environment since income is generally more sensitive to changes in interest rates than expenses are. In theory, credit unions with higher ratios of fee income to total income should see less fluctuation in the efficiency ratio than credit unions with little fee income.

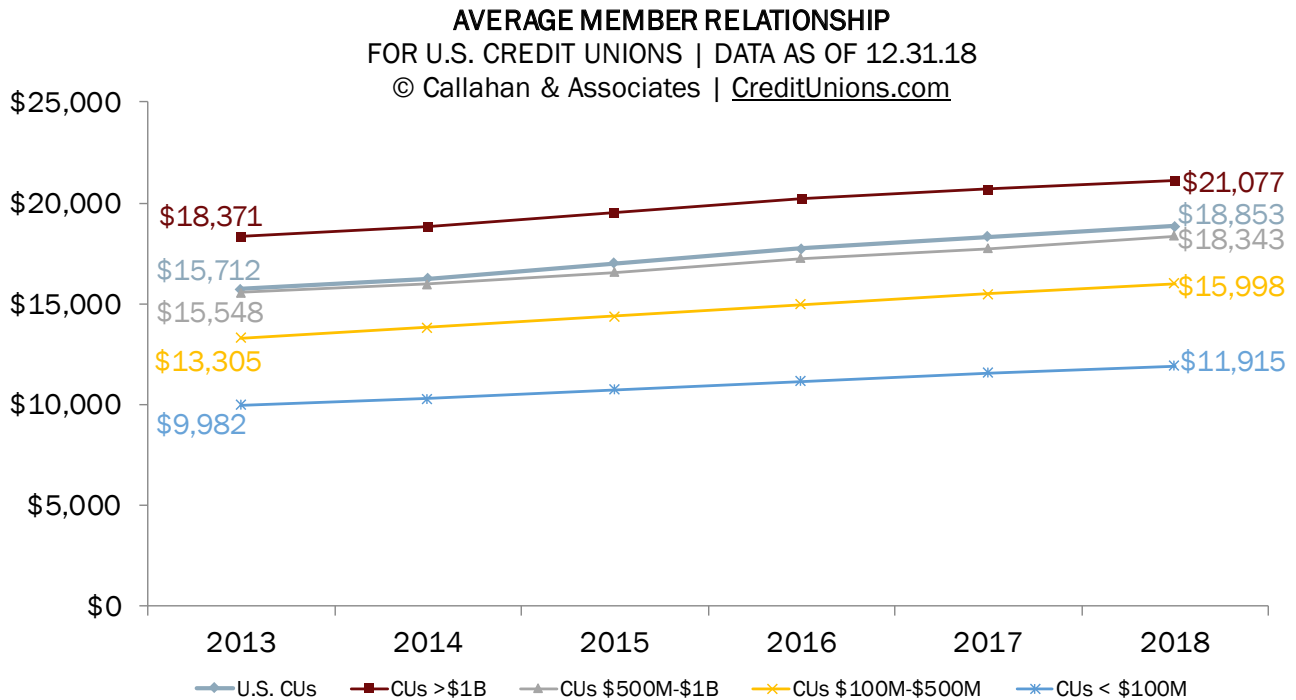
Chief Lending Officer

AVERAGE MEMBER RELATIONSHIP

Definition: Average member relationship is calculated by dividing the sum of loans outstanding and total shares by the number of members the credit union serves.

National average (as of year-end 2018): \$18,853

$$\frac{(\$) \text{ Loans Outstanding} + (\$) \text{ Total Shares}}{\# \text{ of Current Members}}$$



The resulting measure represents the average value of loans and deposits an individual member has with the credit union. The credit union’s pricing strategy, underwriting policies, and product mix all contribute to this performance measure. In addition, the makeup of the field of membership, the current economic environment, and the credit union’s ability to sell loan and deposit products can also have measurable impact on the average member relationship.

DELINQUENCY

Definition: Delinquency is calculated by dividing the total amount of delinquent loans by the total amount of loans outstanding.

National average (as of year-end 2018): 0.71%

$$\frac{(\$) \text{ Delinquent Loans}}{(\$) \text{ Loans Outstanding}}$$

A credit union’s delinquency ratio is a measure of the current credit risk associated with the credit union’s loan portfolio. It is a forecaster of future loan losses, therefore unusual increases or decreases generally impact future earnings. The level of delinquency a credit union can sustain is a function of several factors, including income generated by the loan portfolio, management of credit risk, and ability to manage loan losses. Risk-based pricing is often accompanied by higher delinquency which should be compensated for by higher loan yields. Conversely, low delinquency rates can imply that the credit union’s underwriting policies are too conservative. This ratio should be evaluated in conjunction with the credit union’s loan-to-share ratio, loan loss ratio, and ROA.

NET CHARGE-OFFS

Definition: The net charge-offs ratio is calculated by subtracting year-to-date recoveries from year-to-date charge-offs and dividing the difference by the amount of average loans outstanding.

National average (as of year-end 2018): 0.57%

$$\frac{\text{YTD Charge-Offs} - \text{YTD Recoveries}}{(\$) \text{ Average Loans Outstanding}}$$

The net charge-offs to loans ratio measures the credit union’s past management of credit risk. In general, the lower the ratio, the healthier the credit union. Changes in lending strategies typically take 12 to 18 months to be reflected in charge-off statistics. This ratio has a direct impact on the credit union’s ROA. Two of the primary components of credit risk management that impact the charge-off ratio are underwriting policies and debt collection procedures. Risk-based pricing, membership demographics, and the loan mix of the credit union are all underwriting components that impact the quality of originated loans. The timeliness and aggressiveness of collection efforts also directly impact charge-off levels.

COVERAGE RATIO

Definition: The coverage ratio is calculated by dividing the allowance for loan and lease losses by the amount of delinquent loans.

National average (as of year-end 2018): 124.4%

$$\frac{\text{Allowance for Loan \& Lease Losses}}{(\$) \text{ Delinquent Loans}}$$

The coverage ratio measures the adequacy of the credit union’s reserves to cover potential losses in its loan portfolio. Delinquent loans forecast future losses; the allowance for loan losses are the reserves set aside to cover loan losses. Because the allowance is funded from current earnings, a declining ratio from an increase in delinquent loans indicates the credit union will have to increase the allowance account as those loans turn into losses. A declining trend in the ratio indicates an under-funded allowance.

LOAN-TO-SHARE

Definition: The loan-to-share ratio is calculated by dividing the total amount of loans outstanding by the total amount of share deposits at the credit union.

National average (as of year-end 2018): 85.5%

$$\frac{(\$) \text{ Loans Outstanding}}{(\$) \text{ Share Deposits}}$$

The loan-to-share ratio is driven by the credit union’s loan and deposit acquisition performance. Most credit unions concentrate on building the loan portfolio while focusing less on deposits, unless liquidity is an issue. In general, loan growth can be influenced more by the credit union’s operations (sales culture, marketing, product development, risk management, etc.) than deposit growth. Deposit growth is generally influenced more by non-operational factors like membership demographics than by operational factors. In general, a higher ratio indicates greater profitability.

Chief Marketing Officer

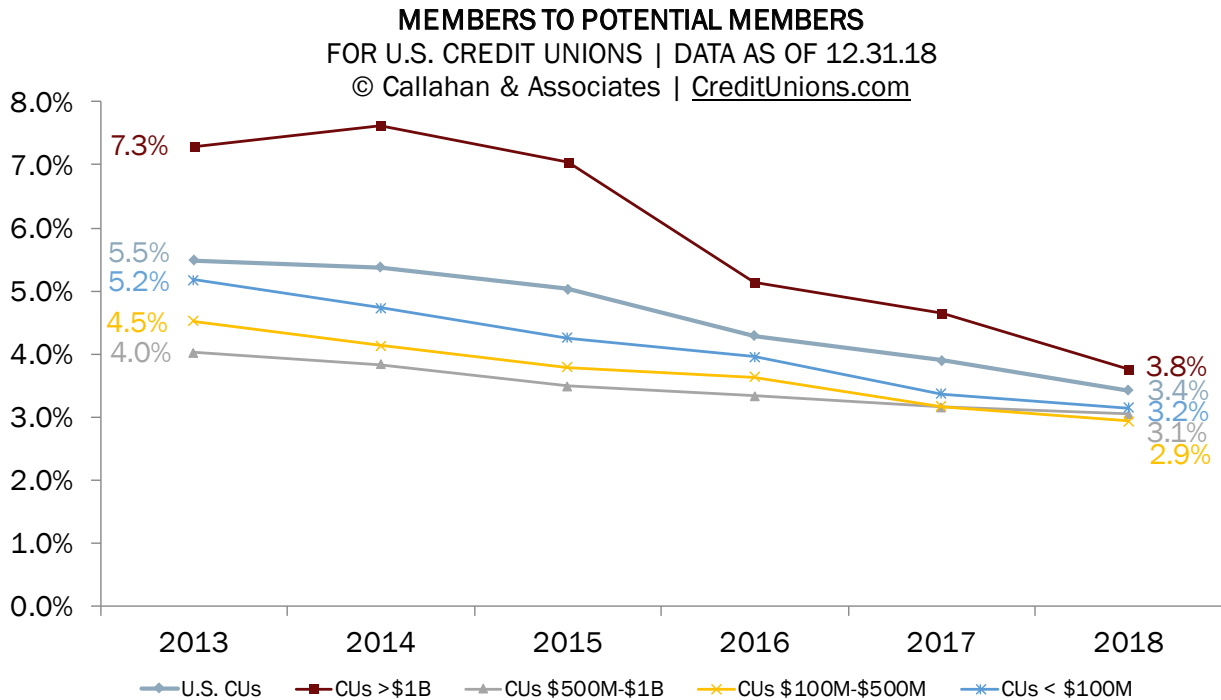
MEMBERS PER POTENTIAL MEMBERS

Definition: This is calculated by dividing the number of members of the credit union by the number of potential members in the credit union's field of membership.

National average (as of year-end 2018): 3.4%

of Current Members

of Potential Members



This ratio measures the extent to which the credit union has penetrated its field of membership. A smaller value for this metric would indicate either that the credit union has the potential to add a significant number of members and deposits, or that is not effectively marketing its products to potential members in its served markets.

NET NEW MEMBERS PER BRANCH

Definition: This ratio is calculated by dividing the number of new members by the number of branches the credit union has.

National average (as of year-end 2018): 233

$$\frac{\text{Net New Members}}{\# \text{ of Branches}}$$

Net new members per branch is important for gauging the productivity of the credit union’s marketing expenses and employee selling initiatives. Being able to account for advertising and promotional expenses is important in quantifying both their necessity and success.

AUTO PENETRATION

Definition: Auto penetration is calculated by dividing the number of auto loans outstanding (both new and used) by the number of members the credit union serves.

National average (as of year-end 2018): 21.2%

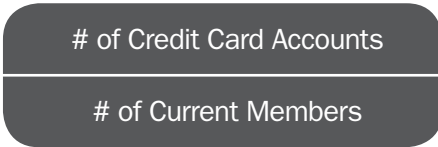
$$\frac{\# \text{ of New Auto Loans} + \# \text{ of Used Auto Loans}}{\# \text{ of Current Members}}$$

This ratio shows the average number of auto loans per member. Auto loans can be highly profitable, have broad market appeal, and are a productive use of operational resources when correctly implemented. Successful auto lending credit unions generally depend on strong sales and marketing efforts in addition to dealer relationships and solid risk management policies.

CREDIT CARD PENETRATION

Definition: Credit card penetration is calculated by dividing the number of credit card accounts by the number of members the credit union serves.

National average (as of year-end 2018): 17.6%

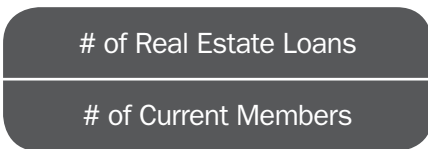


Credit card penetration represents the percentage of members who have a credit card loan with the credit union. A higher penetration rate can indicate that member engagement strategies are working and stronger member relationships are being built.

REAL ESTATE PENETRATION

Definition: Real estate loan penetration is calculated by dividing the number of real estate loans outstanding by the number of members the credit union serves.

National average (as of year-end 2018): 4.5%



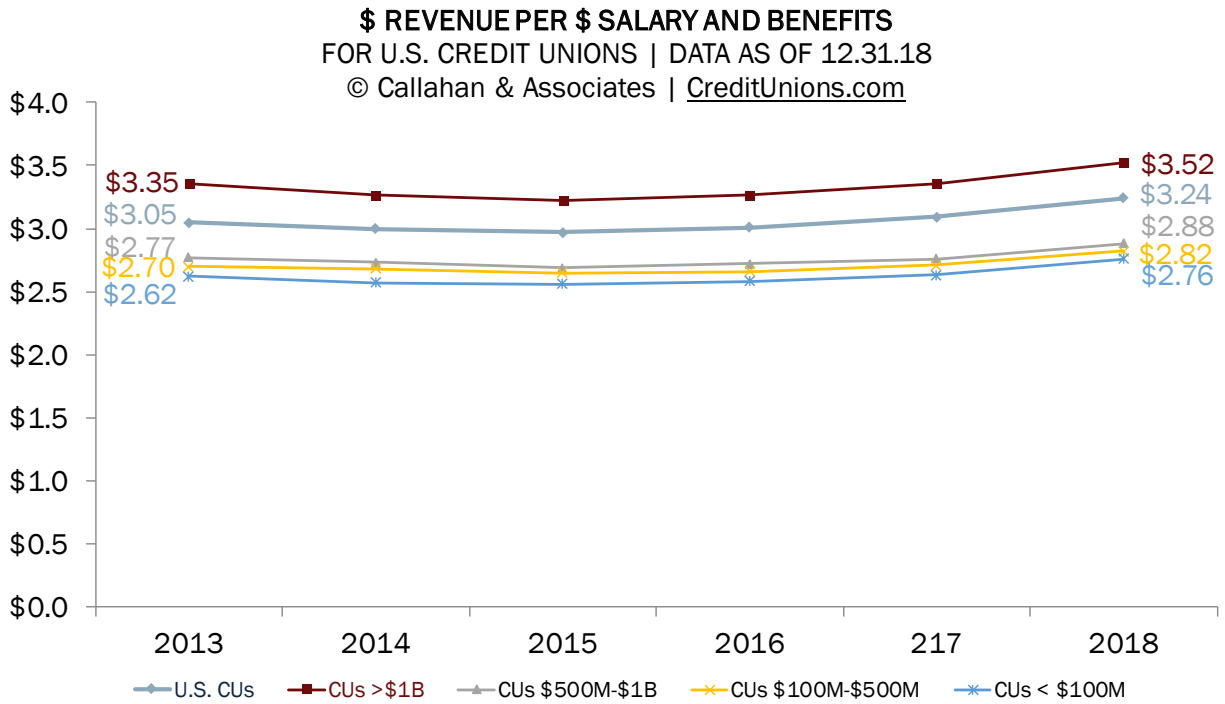
This ratio shows the percentage of members who are using the credit union’s real estate loan services. Although a higher number indicates stronger member engagement, if the credit union is primarily a consumer lender, has a young mortgage program, or mostly sells mortgages to the secondary market this ratio may be lower.

HR

\$ REVENUE PER \$ OF SALARY AND BENEFITS

Definition: This ratio is calculated by dividing total revenue by employee compensation and benefits.
National average (as of year-end 2018): \$3.24

$$\frac{\text{Total Revenue}}{\text{Employee Compensation and Benefits}}$$



This ratio evaluates the credit union’s total employee compensation relative to the total income generated by the institution. Again, as salary and benefits are the largest expense for credit unions, measuring the income generated by those same employees is crucial. Credit unions in metropolitan areas or areas with high cost of living may see a lower ratio as costs to hire and retain talent are higher than in more rural areas.

MEMBERS PER EMPLOYEE

Definition: Members per employee is calculated by dividing the number of members by the number of full-time equivalent employees.

National average (as of year-end 2018): 385

of Current Members
of Full-Time Employees

This ratio measures the productivity of the credit union’s employee base. Given that human resources costs are typically credit unions’ largest operating expense, this ratio is critical. In theory, a higher ratio means a credit union is more productive, but other factors also play a part. When examining the ratio, credit unions should also consider product penetration rates, members per branch location, the geographic distribution of the membership, and field of membership requirements. Strategic factors that impact the ratio include organizational service level goals, growth, and product and technology development.

SALARIES AND BENEFITS PER EMPLOYEE

Definition: Salaries and benefits per employee is calculated by dividing employee compensation and benefits by the number of full-time equivalent employees.

National average (as of year-end 2018): \$75,148

Employee Compensation and Benefits
of Full-Time Employees

As previously stated, human resource-related expenses are typically a credit union’s single largest operating expense. The average salary and benefits paid per employee is impacted by location, employee productivity, the board of director’s philosophy toward compensation and benefits, and the organizational structure. Credit unions with highly productive operations generally have fewer employees who are compensated with a higher salary. So while the average cost per employee may be high, the overall cost may be less than its peers.

LOAN ORIGINATIONS PER EMPLOYEE

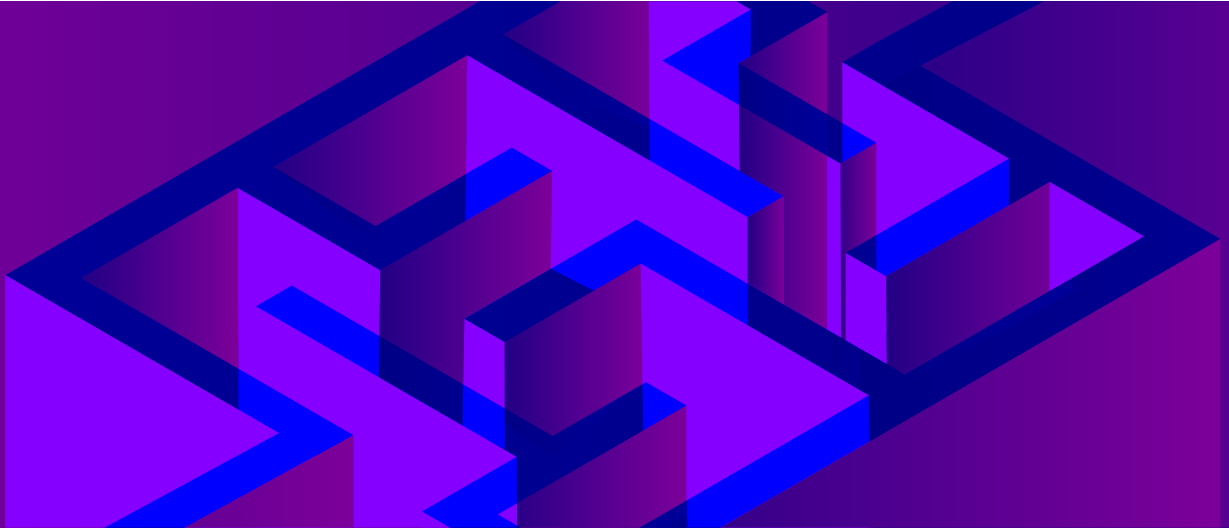
Definition: This ratio is calculated by dividing the annualized amount of loan originations by the number of full-time equivalent employees.

National average (as of year-end 2018): \$1,674,358

(\$) Annualized Loan Originations

Full-Time Equivalent Employees

The higher this ratio, the more productive the credit union's employees are at generating member loans. The loan component of this performance measure is a reflection of the credit union's lending philosophy, employee training programs, and the members' propensity to borrow.



COMMON BENCHMARKING PITFALLS

When done correctly, benchmarking is an extremely valuable tool that provides important insight into various areas of a credit union's operating model. However, any errors committed during the benchmarking process can give you a faulty picture of your credit union's performance. The following are three areas where errors are most likely to occur.

Peer Group Selection

When selecting a comparison group to benchmark against, it's important to think beyond just geographic proximity and asset size. Including other factors in your benchmarking efforts, such as charter type, field of membership, and type of vendors used provides a more accurate comparison for your institution. When it comes to benchmarking, you want to be as accurate as possible to ensure you're correctly gauging performance.

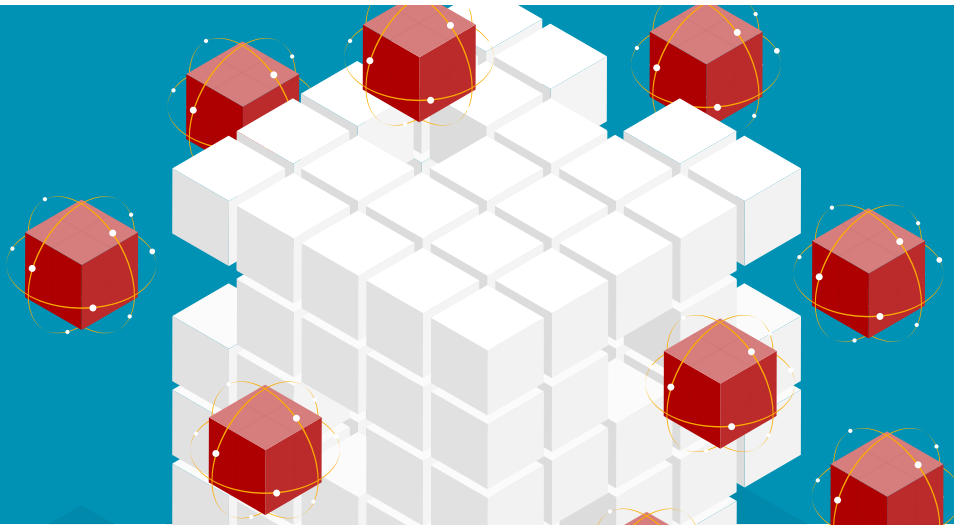
It can also be beneficial to look at slightly different peer groups from time to time. Benchmark against credit unions with a slightly larger asset size or look at market leaders in certain key areas. You may be able to pinpoint factors that have allowed that institution to reach its current level of proficiency.

Benchmarking Frequency

Given the dynamic nature of the credit union industry, conducting benchmarking efforts only once a year can hide performance lags for months at a time. Whether it's interest rates, membership demographics, or changing housing market prices, the barometer for credit union success is constantly shifting. With this in mind, it makes sense to benchmark at least on a quarterly basis.

Identifying Potential Peers

Your benchmarking comparisons shouldn't be limited to other credit unions since banks are likely also competing to be the financial service provider of members in your market. While differences between NCUA and FDIC reporting formats made it difficult to make credit union to bank comparisons, there are now tools available that allow you to make apples-to-apples comparisons. While you should not make general market-to-market comparisons for metrics such as loan rates and fees, consider using bank peers in certain circumstances, such as when looking at market share, setting market-based growth goals, and identifying market trends.



BENCHMARKING METHODS

Once you have an understanding of what you are measuring and who you are measuring against, the next step is finding the most accurate, accessible data and choosing how to conduct your analysis. Below are several different methods for benchmarking against your peers.

Regulator – Every quarter, the NCUA releases the 5300 Call Report, which includes self-reported data for every U.S. credit union. You can access this information on the NCUA’s website. While doable, benchmarking using this method is time-consuming and complicated since the data is released in massive files which you then have to parse through to get the data you need.

Trade associations and CUSOs – Credit Union Service Organizations (CUSOs) are another place to find data on the credit union industry. However, this information is often presented as market snapshots and can be limited to fixed peer groups, which means you may not get the most accurate comparisons for your institution.

Credit union state leagues – Leagues compile data on the states they represent, typically in the form of quarterly reports. Some also compile data on specific lending and growth measures. While useful, the data misses out on national economic trends and also may not be granular enough to provide truly accurate benchmarks for your credit union.

Data software – This option represents the easiest and most robust benchmarking choice. You’ll want to look for a solution that covers the entire 5300 Call Report, bank data, and also provides useful custom ratios. The best options allow users to easily create peer groups based on a multiple criteria (geography, charter type, financial metrics, etc.), while also providing one-to-one and national benchmarking. Other things to look for include numerous export options, support from expert financial analysts, and those that also incorporate educational materials.



CONCLUSION

Performance benchmarking is vital for ensuring your credit union is on the right track toward success and should be a routine part of operations. Otherwise, your perceptions about your credit union's performance can become skewed and lead to faulty strategic decisions.

Key to effective benchmarking is thinking beyond just asset size or geographic proximity when comparing your credit union to other financial institutions. The more criteria you use when creating comparison groups, the more accurate your performance analysis will be. So, you'll want to think of things like type of core processor used and SEG group when benchmarking as well.

Make sure to benchmark as frequently as possible. When you benchmark at least once a quarter, you can spot trends as they arise and adjust accordingly. Benchmarking frequently is easier than ever thanks to advances in performance analysis software made specifically for credit unions.

And remember, even if you aren't a CEO or CFO, performance benchmarking is still extremely beneficial. It allows you to find your department's strengths and weaknesses, so you can get the most out of your department.

If you aren't benchmarking, you're skipping out on the foundation for improved performance.

ABOUT CALLAHAN & ASSOCIATES

Since 1985, Callahan & Associates has been devoted to providing strategic counsel to the industry through the power of our data, best practice content, networking events, and consulting services.

To find out more about our benchmarking software or any of our other resources, visit Callahan.com or call 800-446-7453.