

The Interdependent Credit Union

**A Rationale and Blueprint for
the Design and Development of a
Collaborative Business Model for
the Reduction of Common
Operating Expenses**



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Some of the most successful credit union ventures through the years have come from credit unions willing to collaborate for the greater good. But the press of daily operations, budget constraints and logistical considerations often leave little time to plan opportunities that lend themselves to collaboration. The Rochdale Group, Inc. was created to fill this vital need. By combining its staff's technical expertise and extensive knowledge of the credit union industry, The Rochdale Group brings together credit unions and business partners to achieve the economies of scale needed to thrive in a fast-changing, competitive environment.

The Rochdale Group takes its name from the early origins of cooperatives. In 1844, workers banded together to open a cooperative grocery store in the community of Rochdale (near Manchester, England). That group eventually became "The Rochdale Equitable Society of Pioneers," which required the purchase of at least one share (costing one pound) to become a member. The Society used its collective share to buy discounted goods for resale to members at below-market prices. The Society's model was replicated and spread throughout Europe, setting the stage for a cooperative banking system to emerge in Germany in the mid-1880's.

As our roots suggest, collaboration is, or ought to be, a critical component of today's credit union strategy. While credit unions account for more than \$670 billion in assets, that figure represents only six percent of banks' total assets. And with shrinking margins, growing member demands, and the need for significant investments in technology, it is becoming ever more difficult for credit unions to compete with large, multi-national banks. To succeed, credit unions must improve their operating efficiencies – efficiencies that often can be gained by working with other credit unions.

Through the acquisition of Counter Intelligence Associates (CIA) and in partnership with credit union management consultant, George Towle, formerly of the ProCon Group, The Rochdale Group & CIA provides premier consulting services. Counter Intelligence Associates is unique from other financial services consulting firms.

The Rochdale Group is keenly aware of issues and trends affecting our clients' ability to remain competitive and profitable in an ever-changing financial services marketplace. We currently serve more than 500 credit union related entities (credit unions, corporate credit unions, leagues, CUSOs, associations, councils and other credit union organizations) throughout the United States, Canada and Puerto Rico.

Mike Hales, formerly president of Counter Intelligence Associates, is a partner with the Rochdale Group where he specializes in CUSO development and Business Services. Mike sits on the boards of the National Association of Credit Union Services Organizations (NACUSO) and Shared Resources Technology Group (SRTG), a multiple credit union owned technology CUSO. He has assisted in the development and launch of more than a dozen multiple credit union owned CUSOs serving in excess of 150 credit unions.

While teaching at Princeton, Albert Einstein was approached by a disheveled graduate student who breathlessly exclaimed, “Professor, the questions on this year’s final exam are exactly the same as last year’s questions”. Einstein paused, looked the student in the eye and replied, “Yes, that’s true – the questions are the same. But this year, all the answers are different”.

The answers are, indeed, different. Why? Because in the face of rapid industry consolidation, a forever-changing economic landscape, increasing compliance burdens, an aging membership demographic and the indications of mounting pressure to unify the financial services industry, the “traditional” credit union business model no longer works.

2009 marks the one-hundredth anniversary of credit unions in America. In 1909 St. Mary’s Peoples Bank opened its doors as the nation’s first cooperative financial institution, giving birth to an industry of people helping people, dedicated to enhancing the financial well-being of underserved Americans. During the ensuing 100 years credit unions grew in number to 23,876 in the mid-1960s.

Then came the downhill slide and the number of credit union charters began to shrink. In the late 1980s and early 1990s, the financial community began to suffer from a major economic downturn that spelled disaster for thousands of financial institutions – thrifts, banks and credit unions alike. Over the next two decades many of the nation’s largest financial institutions reinvented themselves and their approach to financial services delivery by transforming into technology-driven, back-room consolidated, centralized decision-making sales oriented financial services providers. Competition between banks and credit unions increased. Many credit unions abandoned the single sponsor or multiple SEG business model and adopted community charters, theoretically positioning themselves to compete head-to-head with the commercial banking industry for valuable member and small business relationships.

And yet, while the number of credit union members increased, the number of credit unions continued to shrink. Today, in 2008, there are approximately the same number of active credit union charters as there were at the end of World War II.

“U.S. credit unions have been consolidating at a steady pace since the mid-1970s. Recently, this pace of consolidation has become more pronounced, with an average of about 300 credit union mergers taking place per year...about one a day. What is driving this trend? The major issue seems to be the need for economies of scale. Consumers and regulators demand more from financial institutions and it is difficult for smaller credit unions to offer the same level of service as larger institutions. Overwhelmingly, smaller credit unions are the victims of consolidation.”¹

¹ “A Preliminary Study on Credit Union Franchising”, Filene Research Institute, 2007

The Credit Union Industry: 1980 to 2007

	1980	1990	2000	2005	2006	2007
Operating credit unions						
Federal	12,440	8,511	6,336	5,393	5,189	5,036
State	4,910	4,349	3,980	3,302	3,173	3,065
Number of failed institutions	239	164	29	15	16	12
Members (000)						
Federal	24,519	36,241	43,883	47,914	48,254	48,474
State	12,338	19,454	33,705	36,896	37,499	38,363
Assets (\$ millions)						
Federal	\$40,092	\$130,073	\$242,881	\$377,826	\$394,130	\$417,579
State	20,870	68,133	195,363	300,871	315,817	335,885
Loans outstanding (\$ millions)						
Federal	26,350	83,029	163,851	249,521	270,418	289,170
State	14,852	44,102	137,485	208,734	223,917	237,755
Shares (\$ millions)						
Federal	36,263	117,892	210,188	321,831	333,914	349,101
State	18,469	62,082	169,053	255,588	267,274	283,298

Source: National Credit Union Administration.

The chart that follows illustrates CUNA's economic forecast for the number of credit unions, by asset category, as of year- end 2013 – a mere five years from now:

Assets	# of CUs	% of Cus	% of ttl Assets	% of ttl mbrs.
<20M	2,568	41.7	1.9	3.7
20-50	1,294	21.0	3.2	5.4
50-100	738	12.0	3.9	5.7
100-200	546	8.9	7.2	7.8
200-500	569	9.2	16.1	17.6
500-1B	224	3.6	14.8	16.4
>1B	222	3.6	52.9	43.3

Source: CUNA Research and Statistics

Many will agree that to a certain extent consolidation is healthy, just as pruning a tree strengthens the existing structure and promotes new growth. But once momentum has been established, how and when does the pruning stop? At the present rate of consolidation, and under the assumption that the smallest credit unions will consolidate first – (the smallest go away and the biggest get bigger), the credit union industry could consist solely of 1,000 billion dollar-plus asset size institutions in less than 25 years.

Who will disappear and who will remain? Will it ever go that far? At what point will Congress ponder the value of a separate regulator and insurance fund for the credit union industry? We have already seen arguments in favor of a consolidated financial services industry with a single regulator and insurance fund².

Performance Divergence.

Let's get back to the present. We are a shrinking industry of several thousand predominantly small financial institutions. On average, larger credit unions are performing more profitably and efficiently and serving their members better than smaller credit unions. The past 25 years have reflected a continuing widening gap in financial performance between large and small credit unions. Between 1980 and the end 2007, the number of small credit unions (less than \$100 million in assets) shrank by more than 10,000 charters from 17,132 to 7,126 while the number of credit unions with assets in excess of \$1 billion has grown from 2 to 127. If performance divergence continues, it is likely to quicken the pace of consolidation in the credit union industry. And there is every reason to believe that it will.

CREDIT UNION DISTRIBUTION BY ASSET SIZE, 2007

Asset size (\$ millions)	Number of credit unions	Percent change from Dec. 2006	Assets (\$ millions)	Percent change from Dec. 2006
0 to \$0.2	143	-9.5%	\$16	-11.4%
\$0.2 to \$0.5	291	-2.7	101	-2.7
\$0.5 to \$1	378	-7.6	281	-8.2
\$1 to \$2	578	-4.3	850	-4.5
\$2 to \$5	1,117	-5.7	3,797	-5.6
\$5 to \$10	1,202	-5.1	8,741	-5.1
\$10 to \$20	1,210	-3.1	17,429	-3.1
\$20 to \$50	1,410	-3.2	45,403	-3.1
\$50 to \$100	797	1.0	56,104	1.6
\$100 to \$200	532	-0.2	75,082	-0.5
\$200 to \$500	429	1.4	133,107	1.6
\$500 to \$1,000	182	3.4	124,964	4.4
More than \$1,000	127	9.5	310,711	14.3
Total	8,396	-5.2%	\$776,588	8.0%

Source: NCUA - Credit Union 5300 Reports

² March 2008 "Blueprint for a Modernized Financial Regulatory Structure", Treasury Secretary Henry Paulsen

Return on Average Assets (ROA) is generally accepted as a valid performance indicator and a key component of ROA is operating (non interest) expense which consists primarily of wages, benefits, costs of occupancy and supplies, regulatory compliance, and office operations. ROA is important to credit unions in particular because, in effect, those retained earnings are the only source of the additional capital that regulators require in order for a credit union to grow and thereby benefit from economies of scale.³ On average, non interest expenses at small credit unions are about one and a half times as large as those for large credit unions.⁴

The average larger credit union earns more net income and pays more interest to its members than small credit unions. Because larger credit unions have substantially lower non interest expenses than small credit unions do, they have the wherewithal to pay higher interest rates and to generate higher earnings. Since 1980, large credit unions paid about 40 basis points more in interest to their members than small credit unions.

Then there's the issue of safety and soundness. Smaller credit unions bear the highest burden of risk. For example, credit cards and unsecured loans total 21% of the combined portfolio of credit unions under \$5 million in assets and 16% of the combined portfolio of credit unions between \$5 and \$20 million, while totaling just 10% of the combined portfolio of credit unions with total assets over \$100 million. (See Charts A and B, below).

A. Loan Portfolio by Asset Category, Year End 2007

Portfolio \$ Distribution	<\$5mil	\$5-\$20	\$20-\$100	>\$100mil
Credit Cards / Total Loans	1.3%	3.8%	4.7%	5.9%
Other Unsecured / Total Loans	19.6%	11.9%	6.7%	4.0%
New Auto / Total Loans	31.4%	24.3%	17.5%	15.9%
Used Auto / Total Loans	32.0%	27.3%	22.7%	15.6%
First Mortgage / Total Loans	3.4%	12.8%	24.8%	36.4%
HEL & 2 nd Mtg / Total Loans	4.2%	12.3%	17.0%	17.7%
MBL / Total Loans	0.4	1.0%	2.9%	5.7%

³ Federal Reserve Bank of San Francisco Economic Letter Number 2005-29, November 2005

⁴ Federal Reserve Bank of San Francisco Economic Letter Number 2006-19, August 2006

B. Performance Indicators, Year End 2007

	<\$5 Million	\$5 - \$19 Million	\$20 - \$99 Million	> \$100 Million
Number	2,472	2,387	2,155	1,252
Asset growth	-1.3	1.0	3.4	7.0
Loan Growth	-2.0	0.7	2.9	8.5
Member Growth	0.0	1.2	3.9	6.1
Loan Delinquency	2.84	1.60	1.21	0.86
ROA	.38	.63	.61	.67

More than 4000 small credit unions, which together hold most of the assets of all small credit unions, have non interest expenses that exceed the average for large credit unions by more than 100 basis points. For a time, many of these credit unions will likely survive, if not thrive. However, their earnings and interest rates are likely to preclude growth sufficient to reduce their average costs significantly. As a result, these credit unions will likely constitute shrinking shares of an otherwise sizable and sound industry. Further liberalization of FOMs or other changes that raise the average sizes of credit unions would likely also further stimulate consolidation among credit unions.

Performance divergence fuels competition among credit unions. Small, single or multiple sponsored credit unions find it increasingly difficult to compete with large, community chartered credit unions whose field of membership (as defined by geographic boundaries) includes the smaller credit unions' members. In the words of syndicated cartoonist and creator of the Pogo comic strip Walt Kelly, "We have met the enemy and he is us".

Call to Action: The Need for Innovative Collaboration.

Increasing operating expenses coupled with decreasing net interest income is a recipe for disaster. Under the current business model, a growing number of small credit unions – each of which share the same escalating regulatory compliance burden as larger institutions, each of which assume higher credit risk and increasing loan delinquencies, and each of which are finding it increasingly difficult to grow net interest margins in a hostile economy, will merge or fail.

The solution to this scenario can be found in the very roots of the Credit Union Movement. Cooperation and Collaboration have, throughout the proud history of America's credit unions, been the catalyst to success. The sharing of ideas and resources, the historic

unselfish and extraordinary response to momentous calls to action and the heroic role of thousands of Davids taking up arms against thousands of Goliaths, have defined the very mettle of credit unions. Today there is a new Call to Action: Collaborate or Consolidate.

One fundamental solution for the credit union movement to survive lies in the significant reduction of common redundant operating expenses. Several studies have addressed options for centralization of back office expenses, including the Filene Institute reports referenced above.

Many American credit union leaders have looked north of the border to our Canadian cousins and studied the Desjardins Group, a true franchise business model in which more than five hundred separate credit unions share centralized back office functionality, creating an operating model based on “intercooperation”.

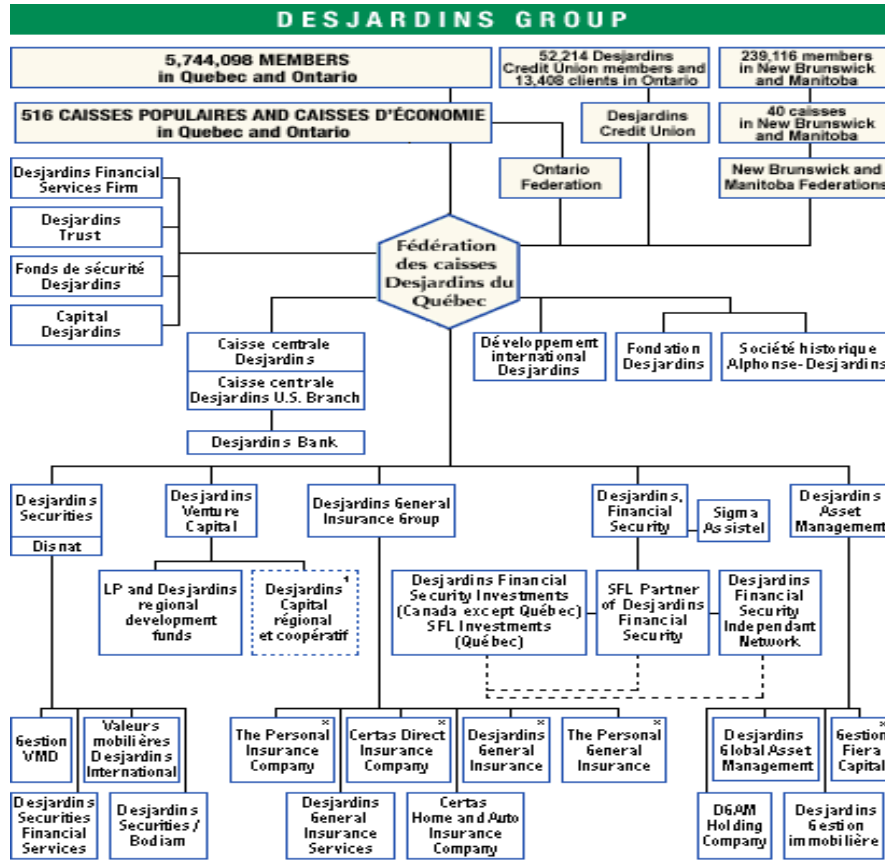
“As one of Canada’s most respected financial institutions, we’ve built our business through cooperation. Our focus will always be to provide a cooperative alternative.

Utilizing a strategic alliance approach, Desjardins offers a behind-the-scenes, wholesale methodology. Partnerships within the co-op system allow all of us to grow and evolve, resulting in a stronger cooperative system able to continually stay ahead of the competition. Sharing costs, expertise, products and services could become the Canadian cooperative system’s response to consolidation and increased competition in the financial services market.

We strongly believe in intercooperation between cooperatives sharing similar values. Desjardins and credit unions have a common goal: to contribute to strengthening the cooperative system in Canada. And with the help of our proven, fully-integrated banking system, cooperatives can keep up with the fast pace of today’s rapidly evolving financial environment.”⁵

The Desjardins model has linked Canadian *caisses populaires* in Quebec and credit unions in other provinces with proprietary securities brokerage, venture capital, asset management, general insurance, life and health insurance, financial planning and commercial banking subsidiaries to serve more than 5.8 million member owners and 400,000 business members with the combined security of more than \$150 billion in assets.

⁵ www.desjardins.com



January 1, 2008

Chart does not reflect the legal ownership structure.

¹ Venture capital public funds managed by Desjardins Venture Capital Inc.

* Shared ownership

In contrast, the American credit union model continues to enjoy significant strength from single or multi-sponsored credit unions who enjoy – if not exploit – the identity of their sponsors. In addition, our entrepreneurial spirit of independence conflicts with the “franchise” model. Many strong credit unions’ survival is based almost exclusively on the identification of the credit union with the local community, a single sponsor, an industry, an association – independence and identity are linked directly to the DNA of many – if not most of America’s credit unions. While Desjardins has created enviable economies of scale and scope in Canada, the franchise model most likely will not work in the United States, at least for the near future.

If not Desjardins, then what?

America is recognized world-wide as synonymous with “independence”. It is the preservation of independence and identity that provides the foundation of competition – the very basis of our economic system. America’s credit unions – whether single sponsored, multi SEG or community chartered, rely on individual identity to compete successfully in a crowded financial services playing field.

Consider, for a moment, the following example of individual identity-focused collaboration:

In the mid-1990s, Cupertino National Bank and Mid-Peninsula Bank, two well performing California community banks joined together to form Greater Bay Bancorp (GBB), a holding company that was established for the purpose of creating economies of scale and scope without destroying the community identification of either institution. Under the holding company, which owned the majority of stock of both banks, neither institution relinquished its charter. Both banks continued to promote their ties to their local communities and to grow their assets while consolidating their back office functions to the holding company. Management, credit, operations, technology, human resources, forms, policies – all were consolidated, freeing both institutions from the burdens of administration and back office functions.

Over the next several years, more than a dozen more community banks throughout the San Francisco Bay Area were brought under the holding company. While each maintained their charter and identity and each continued to promote ties to their local community, back office functions were consolidated and the profitability of each institution, and thus the holding company, improved significantly.

The difference between GBB and The Desjardins Federation is the preservation of identity of each of the “subsidiary” or “member” institutions. While individual identity is dissolved through Desjardins, it was enhanced through GBB.

Exploding the “common platform” myth.

A striking similarity between GBB and The Desjardins Federation is the commonality of core processing – centralization of technology in a common platform. According to Lucie Bouchard, Vice President, Federation des caisses Desjardins du Quebec, “the cooperative network operates on a common platform. There’s also a strong linkage to the corporate network as the acquiring process of all products available through the cooperative network is highly automated.” Desjardins’ common technology platform is illustrated as follows:



Within credit union circles there is a common perception that collaboration of back office functionality requires a unified core processing system. One prominent financial services industry technology consulting firm, Chicago-based BTE Consulting⁶ begs to differ:

“As current US economic conditions compound previously existing pressures, credit unions’ efforts to focus on increasing total assets under management while both reducing costs and increasing productivity have become more difficult. As a direct result, there is renewed interest in outsourcing and collaboration among credit unions. While these are not new ideas, they are once again en vogue and, unlike the past, there are a number of new and exciting integration options available that allow you to cherry pick when and where you integrate all while getting the work done in less time than ever.

When looking at large scale integration projects, collaboration gurus of the past have charted a course in which individual credit unions must first standardize systems and then pursue the work of integrating systems. While this is a sound strategy, the approach is fraught with risk. Primary among these risks are the disruption to business as entire core systems are ripped out and replaced in wholesale. Assuming this transition is successful, it is now that the actual effort of integration and collaboration is pursued.

Integration techniques and tools have undergone a revolution over the past decade. As many businesses have dealt with increased competition in their globalized marketplaces, the need for efficient execution on business process change and the need for quick integration of disparate systems have never been greater. The necessity of the situation has yielded the now well know approach called *Service Oriented Architecture (SOA)*.

At its core, SOA is a way to implement business solutions so that they are not so tightly wound together. Instead of building/rebuilding systems, communications between existing systems are constructed. The benefit being that any one technology is able to speak to another *and* that changes to your solutions are available much more quickly.

At present, there are a wide number of mature standards (like web services and XML) available in support of SOA. Vendors of development tools and middleware also offer deep-rooted support of SOA. For example, both Java and Microsoft’s .NET platform have wide support for these technologies while enterprise packages such as SAP and database products such as Oracle 10i are able to directly consume the XML messages used by web services.

⁶ “The Next Generation of Credit Union Collaboration: Executing on Change Today”, BTE Consulting, Inc, Chicago.

Given the advent of SOA, and the maturity of support, it is now possible to consider reliable alternatives to the old standardize-then-integrate approach. By combining SOA protocols and tools with internal processes while reaching outside to external businesses, you should more easily couple your processes to your



partner's processes. Today, you can focus on using web services to translate specific messages between you and your partners. In other words, with web services, you can now link your business process to your partners. More than this, you need only focus your efforts on the specific integration points required to integrate your processes. Compared to the rip-and-replace methodology, the web services approach is like using a rifle as compared to a rip-and-replace's shotgun approach.

By focusing on integration first, this new collaborative framework allows you to proceed at a much greater pace. Gone are the days of identifying an opportunity only to find yourself capitalizing on it 18 months or more later, today you will measure your time in months and weeks.

The news only gets better: before beginning a transition to a collaborative framework, you must first answer the new questions presented by the SOA approach. When performing a rip-and-replace operation your organization focuses on data migrations in to new systems, training, and other ways to minimize disruption to customers and employees alike. The new approach frees you of many of these shackles, you now examine how existing systems will communicate. Disruptions to customer and employees are greatly minimized. Today, you ask questions of your enterprise architecture by looking at business-driven questions such as:

- What do I have, where is it, and how much does it cost?
- Where am I duplicating efforts and/or technologies?
- Where are my strengths and weaknesses?

Holistic questions such as these produce the information needed to determine how best to approach collaboration with your partner (i.e. on what should I collaborate?) and where to focus your SOA first, next and last.

Top down analysis of your strategic business conditions, your organization, its composition, the business processes, and finally the technologies supporting the automation of these processes ensures that technology efforts are focused on your key business drivers. This, in turn, allows you to make clear, evidence-based rationalizations for the decisions you make. Making clear, evidence-based rationalizations and decisions requires you to effectively understand your environment across all of your businesses

constituencies. The most effective means of creating this understanding is by clearly articulating your enterprise architecture, which is a blueprint for your business. Know now that clearly documenting your enterprise architecture is a delicate balancing act. The trick here is to apply a tool and process requiring enough detail to make the best decision possible while not bogging yourself down in an endless collection of detail and/or forcing a cultural shift in your company's IT department. It is our recommendation that you use a lightweight tool allowing collection of information in the four key domains of your business's DNA:

- **Business** *What drives your business?*
- **Operations** *How is the business being executed?*
- **Systems** *What automates that execution?*
- **Technology** *How is your automation being supported?*

Experience has shown that using the BOST approach in documenting your enterprise architecture allows you to be confident that you will reliably identify those parts of your architecture that are core to the business, those that are ripe for outsourcing or collaboration, and those that are assets allowing you to deliver key capabilities to your partners.

Facing the daunting challenge of large-scale collaboration among credit unions just got easier. It is truly possible to perform lightweight loosely coupled integrations with your partners today: SOA technologies are ripe for deployment within your organization and between you and your partners. However, the real work lies in a self-examination geared toward determining what best to integrate and how best to pursue these integrations. Answering these questions with evidence-based rationalization is the first step to meet then exceed your goals.⁷

- Charles Herman, Senior Architect with BTE Consulting

What Functionality Can or Should be Shared?

The Bankers' Perspective. While collaborative initiatives can certainly be developed for the purpose of increasing revenue and membership growth potential, most credit union executives agree that the immediate focus should be placed on the reduction of common operating expenses. Even commercial bankers have become proponents of outsourcing. The 2008 Community Bank Competitiveness Survey⁸ reports that 36.6% of commercial banks responding to the survey currently outsource functions traditionally performed by staff, and 69.3% of those responding "yes" made the decision to outsource within the last two years. An additional 23.6% of survey respondents indicated that while they do not presently outsource, they are actively considering doing so.

⁷ www.bte-inc.com

⁸ March 2008/ABA Banking Journal

According to the survey, those banks that do outsource report the following “top pics” for outsourcing:

- Internal Audit 52.7%
- Loan Review 48.8%
- Compliance Audit 46.3%
- Item processing 44.8%
- ATM Servicing 44.8%
- IT Management 24.9%
- Compliance 19.4%
- ALCO reporting 18.4%
- Investment management 17.4%
- Training 12.4%
- Human Resources 11.9%
- Marketing 10.0%
- Call Center 6.5%
- Other 9.0%

In addition, banks indicated the following response to the question “What functions would your bank be willing to share with an unaffiliated institution”?

- Internal Audit 32.5%
- Compliance Audit 31.7%
- Loan Review 31.1%
- Compliance 30.8%
- Training 30.6%
- IT Management 28.7%
- Courier Service 23.5%
- Item processing 22.4%
- ATM servicing 21.0%
- Human Resources 18.8%
- Processing facility 14.6%
- Investment management 12.3%
- Marketing 11.3%
- ALCO reporting 11.1%
- Call Center 7.6%

Banks were further asked, “What steps has your bank taken to cut costs or improve efficiencies in the last two years?” (institutions were asked to choose a single selection)

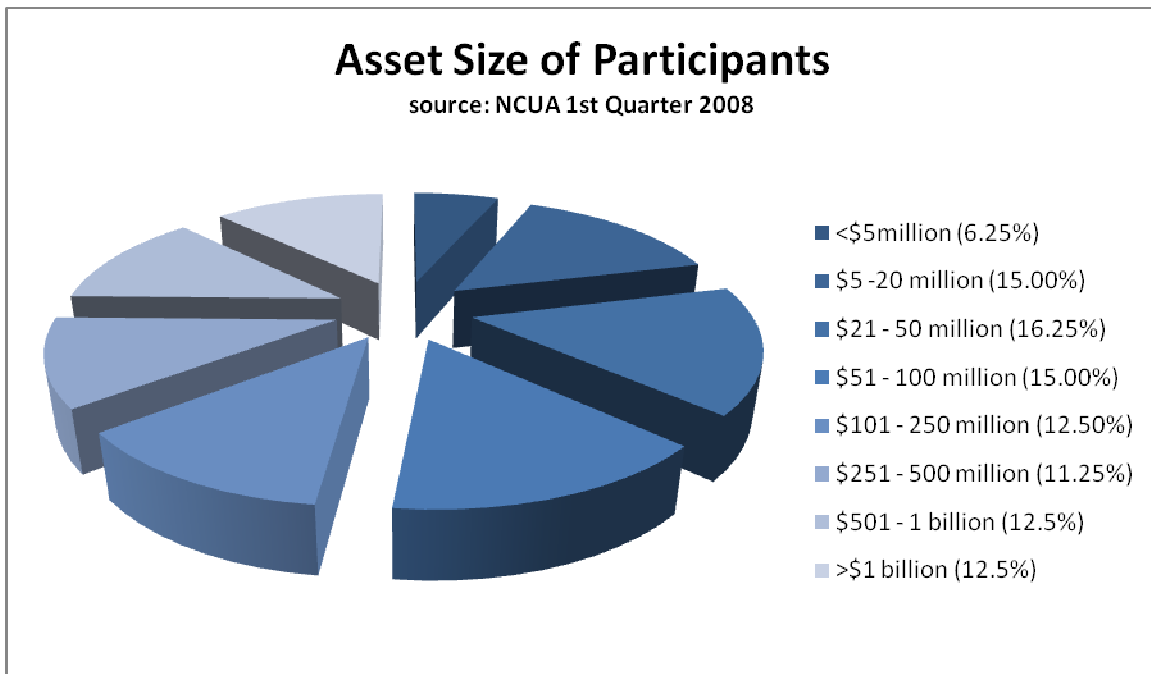
- Revised employee categories/job descriptions 37.8%
- Adopted internal document management system 25.5%
- Installed voice-over-internet-protocol phones 23.5%
- Performed efficiency studies for operational positions (e.g. tellers) 20.9%

- Removed functions, i.e. loan analysis and item processing from branches 14.0%
- Other (cross training, remote capture, check imaging) 11.1%

The participating banks cited the following reasons for outsourcing (note that banks could choose multiple answers):

- To cut costs 60.1% (top reason for banks >\$1 billion)
- To obtain expertise, but not in a full time position 60.1% (top reason for banks <\$1 billion)
- To utilize talent we can no longer find or attract 28.1%
- Other 5.9%

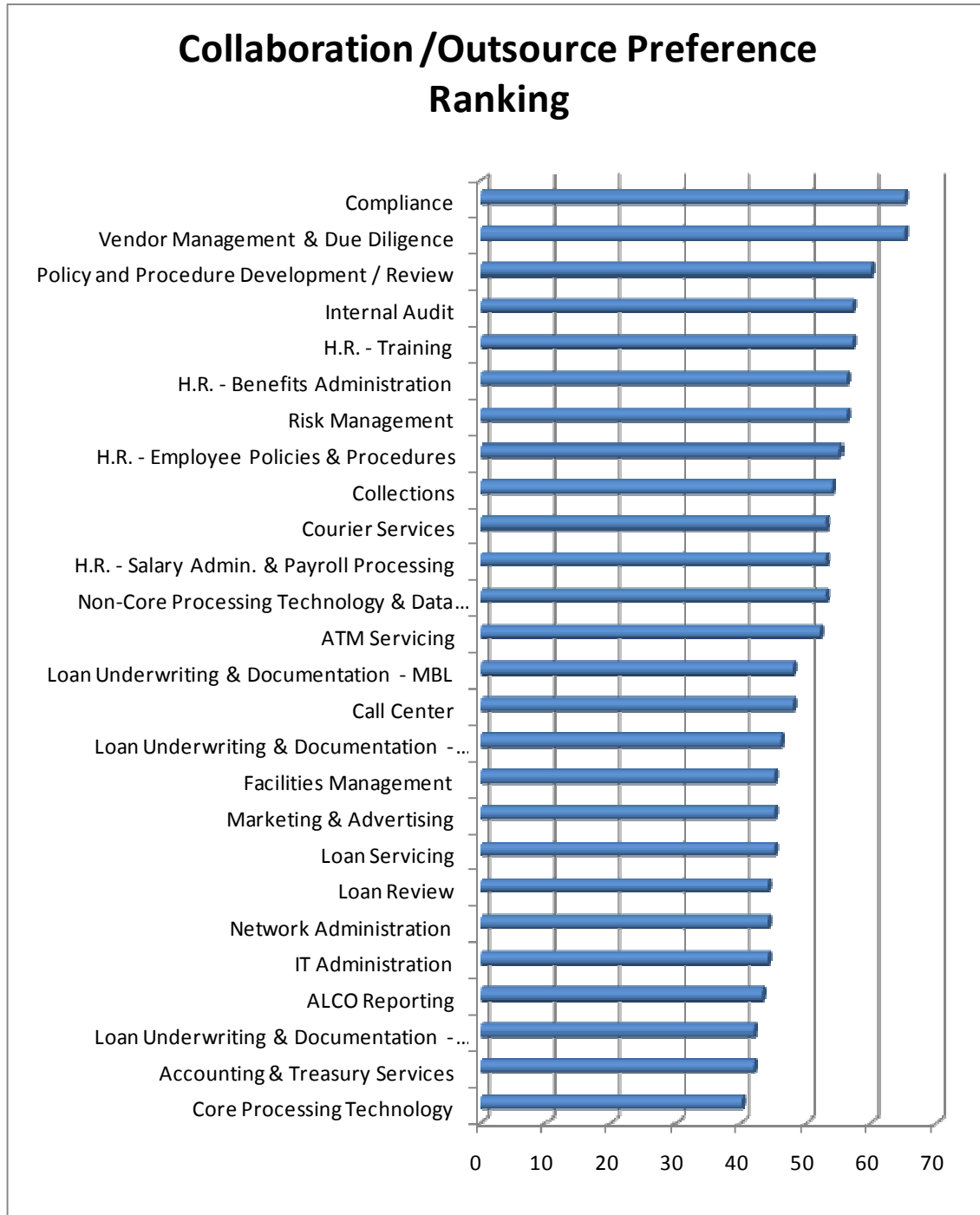
The Credit Union Perspective. The Rochdale Group recently surveyed more than 100 credit unions in order to better determine our Industry’s perspectives on outsourcing and collaboration to reduce common operating expenses. Participants in the survey were distributed, by asset size, as follows:



Participating credit unions were asked to rank traditional in-house functions such as those reflected in the “2008 Community Bank Competitiveness Survey” in order of those most likely to be considered for outsourcing. Participants were provided a list of common back office functions and were asked to respond by choosing one of seven choices: “Definitely Would”, “Probably Would”, “Might”, “Probably Would Not”, “Definitely Would Not”, “Don’t Know” and “Not Applicable”.

The chart on the following page illustrates the ranking in priority order.

Collaboration /Outsource Preference Ranking



Source: The Rochdale Group, Inc.

While the purpose of this section is not to contrast or compare community bank and credit union outsourcing or collaboration priorities, it serves to indicate the commonality of the need to reduce operating expenses of financial institutions in general, and the emerging trend toward finding collaborative solutions.

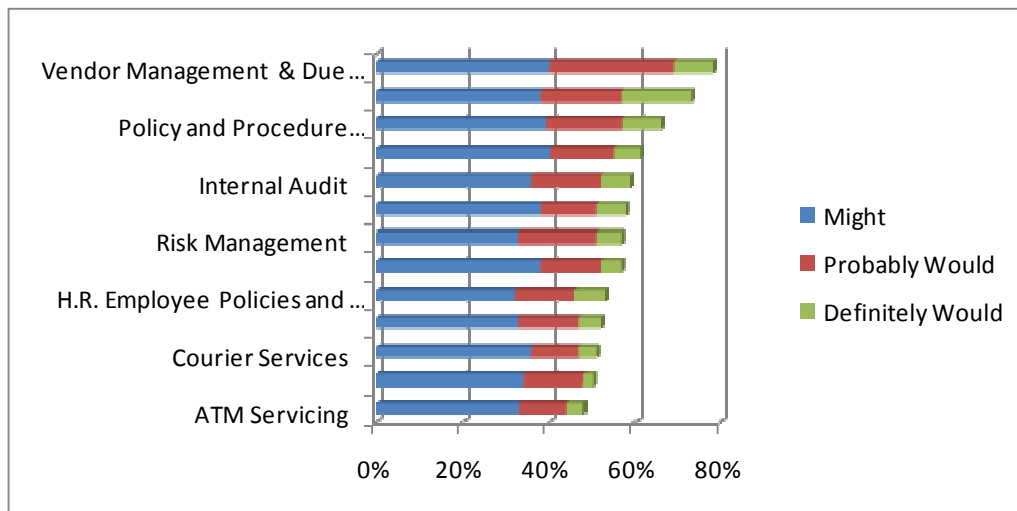
Putting it all Together: A Blueprint for a Successful Collaborative Model- 10 Critical Steps

STEP ONE: Determine the purpose for collaboration. The two most common reasons for entering into a collaborative initiative are expense reduction or revenue growth. Both are valid reasons and both can be accomplished; however, it is recommended that the initial model be created for one of these purposes and then, for only one or two initial functions. The model can be expanded later. For this example, we will assume that the underlying purpose of collaboration is to reduce operating expenses.

STEP TWO: Identify participating institutions. The second step toward large scale collaboration is to meet with other credit unions and establish a group that can comfortably work together and share information with each other. In our experience during the creation of more than a dozen multiple credit union-owned CUSOs in several states, The Rochdale Group has found this to be the most critical stage in the development of a collaborative initiative. There must be a commonality of mutual respect and trust among the partnering credit unions. Egos need to be “checked at the door” and a level playing field should be established among and between all “partners”.

STEP THREE: Engage a qualified consultant to guide you and your partners through the process. Experience dictates that multiple credit union owned ventures are best facilitated with the help of an independent consultant who can ensure that the process moves forward in accordance with an agreed upon time table while assisting in the development of the model.

STEP FOUR: Identify potential opportunities for the reduction of common operating expenses. Rank back office functions in order of interest on the part of each potential credit union partner. Ask questions such as, “which functions are the most expensive to maintain in-house?” or “Which functions are most critical to the survival of all credit union partners?” Create a priority ranking such as the one below:



Source: The Rochdale Group, Inc. 2008

STEP FIVE: Select one back office function with which to start the model. The back office functions identified in Step Three should be prioritized in order of those that would generate the most significant cost savings to all participants. Consideration should also be given to those functions for which one or more of the partners might have excess capacity and could provide the service for the other partners. Determine whether the selected back office function could and should be performed by one of the partner credit unions or whether the function is better suited for outsourcing to a third party provider. Draft your business plan for a replicable and scalable business model.

STEP SIX: Determine what data would need to be shared among all partner credit unions. Determining the data needed by each credit union to operate efficiently without maintaining the selected back office function in-house will define the IT requirements for the transfer of data among credit union partners so that data can be communicated with each institution's core system. Establish the information technology tactical plan – the information sharing blueprint as illustrated in pages 11 – 13, above. Draft your systems and technology plan.

STEP SEVEN: Agree on the structure of the new collaborative model. Too often credit unions or groups of credit unions approach collaboration from the aspect of “form over function” and focus too early on the structure of the entity to be created. The successful collaborative model first identifies the issues relative to the collaborative *function*, then determines the most appropriate collaborative *form*. For this example, it will be assumed that the credit unions agree to form a multiple credit union owned CUSO under the provisions of NCUA Rule 712 and the CUSO will be a Limited Liability Company (LLC). The CUSO's LLC Operating Agreement, policies and procedures, management and governance should be developed at this step. The business plan should be completed including cash flow projections for the first three to five years of operation. Remember to keep the business plan scalable so that additional back office functions can be added at a later date.

STEP EIGHT: Commit to Reducing Staff. This may actually be the most difficult part of the entire process. However, the cost of hiring, maintaining and developing human resources is clearly the most expensive line item on the credit union income and expense statement. Creating efficiencies of scale and scope through collaborative, shared back office functions drives the ability to trim overhead and reduce the heavy burden of compensation, insurance, training and related expenses.

STEP NINE: Test and Launch the Model. After testing any necessary intra-credit union communications and data transfer requirements, all credit union partners should be prepared for a simultaneous launch of the new CUSO.

STEP TEN: Expand the functionality. Once the CUSO is operating efficiently and each participating credit union is satisfied with the efficiencies it has created, the appropriate steps in this process should be repeated to the extent necessary to add additional agreed-upon back office functions, thus creating even greater economies of scale and scope for the partner credit unions.

Summary.

Today's credit unions are challenged by ill winds that blow simultaneously from multiple directions. In and of themselves, a troubled economy, a shrinking industry, expanding compliance regulations, and increased external competition are significant issues. When these factors are coupled with historically high operating costs, low revenues, and increased internal competition due to performance divergence, the validity of the traditional credit union business model must be questioned.

The credit union business model has morphed over the years. While we have worked hard to differentiate ourselves from commercial banks, we have at the same time become more bank-like. Somewhere along the line we seem to have lost sight of who we are.

The industry that was founded on the principles of innovative cooperation exemplified by the Rochdale Society of Equitable Pioneers in 1844 and St. Mary's Peoples Bank Credit Union in 1909 must return to the very basics of its roots: Collaboration. The strength of the Credit Union Movement – the catalyst that has held our industry together for so many years, is collaboration. Today, we face urgent and compelling reasons to return to the tenets of “people helping people” and help each other.

A new business model is developing in which those credit unions that survive and grow will have become less independent and more interdependent.

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