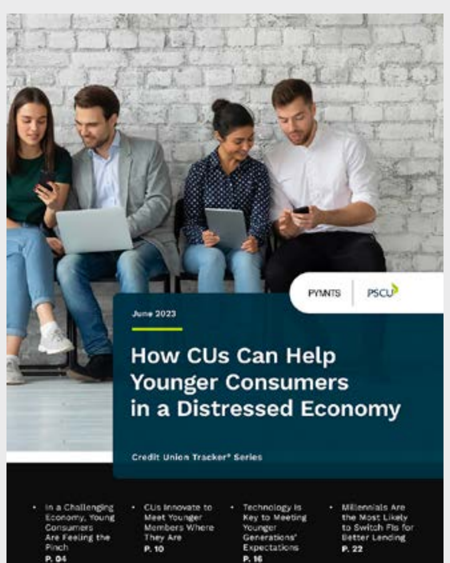
August 2023

Credit Union Consolidation in a Tough Economy

Credit Union Tracker® Series

Read the previous edition



JUNE 2023

Credit Union Tracker® Series

What's Inside

Acknowledgment

The Credit Union Tracker® Series is produced in collaboration with PSCU, and PYMNTS is grateful for the company's support and insight. PYMNTS retains full editorial control over the following findings, methodology and data analysis.

Need to Know

Small Credit Unions Face an Uphill Battle

Credit unions have long occupied a specific market niche within the financial industry, favoring more personalized and member-focused services than their bank counterparts but typically operating on a much smaller scale. This appeal has formed a loyal membership base over the years, with the United States currently boasting 4,712 federally insured credit unions serving more than 136 million members.

This market niche has come under threat in recent years, however, as consumers begin to abandon brick-and-mortar banking service in favor of digital banking. Modern credit unions face more than just their traditional bank competitors when it comes to this digital presence: The rise of digital-native FinTechs has also encroached on their member base.

Banks and FinTechs have targeted CUs' loyal member base in recent years.

4,712

Number of federally insured credit unions in the U.S.

136M

Total CU members in the U.S.

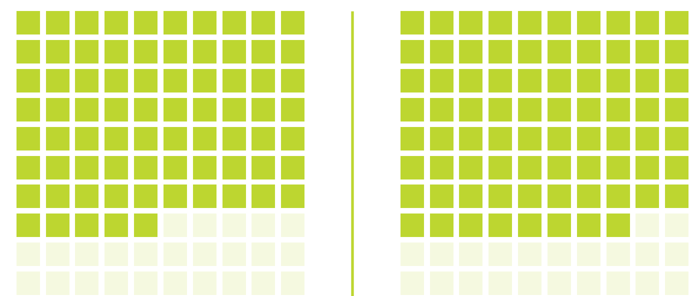
Need to Know

Banks and FinTechs are proving to be fierce competitors to CUs.

These institutions have greater resources and ability than CUs to deploy the digital programs consumers crave. A recent study found that satisfaction with CUs dropped to a score of 75/100, falling behind the banks' score of 78/100 for the fourth year running, thanks in large part to these digital programs.

This decline in satisfaction has increased consumers' willingness to switch from a CU to another type of financial institution (FI). Twenty-seven percent of CU members said in 2022 that they would switch where they keep their financial accounts to find product innovation. In 2018, just 17% of CU members were willing to switch FIs.

CU member satisfaction has been steadily declining over the past four years.



75/100
CU member satisfaction score in 2022

78/100
Bank customer satisfaction score in 2022

Need to Know

CUs face a difficult choice of merging or risking ruin.

PYMNTS research from Q4 2022 found that 49% of CU executives said a lack of resources prevented them from bringing innovations to market, up from the 34% of executives who had the same complaint in Q4 2021. In addition, while 19% of CUs classified themselves as early launchers of new products in Q4 2021, that figure dropped to just 13% in Q4 2022.

CUs are therefore forced to make a difficult choice: Merge with other CUs into single entities and combine their resources or risk being overrun by large banks and FinTechs. As time goes on, more and more CUs are taking the first option.

CUs find themselves strapped for resources to pilot digital innovations.

49%
Share of CU executives for whom a lack of resources is preventing them from bringing innovations to market

19%
Share of CUs that classified themselves as early launchers of new products in Q4 2021

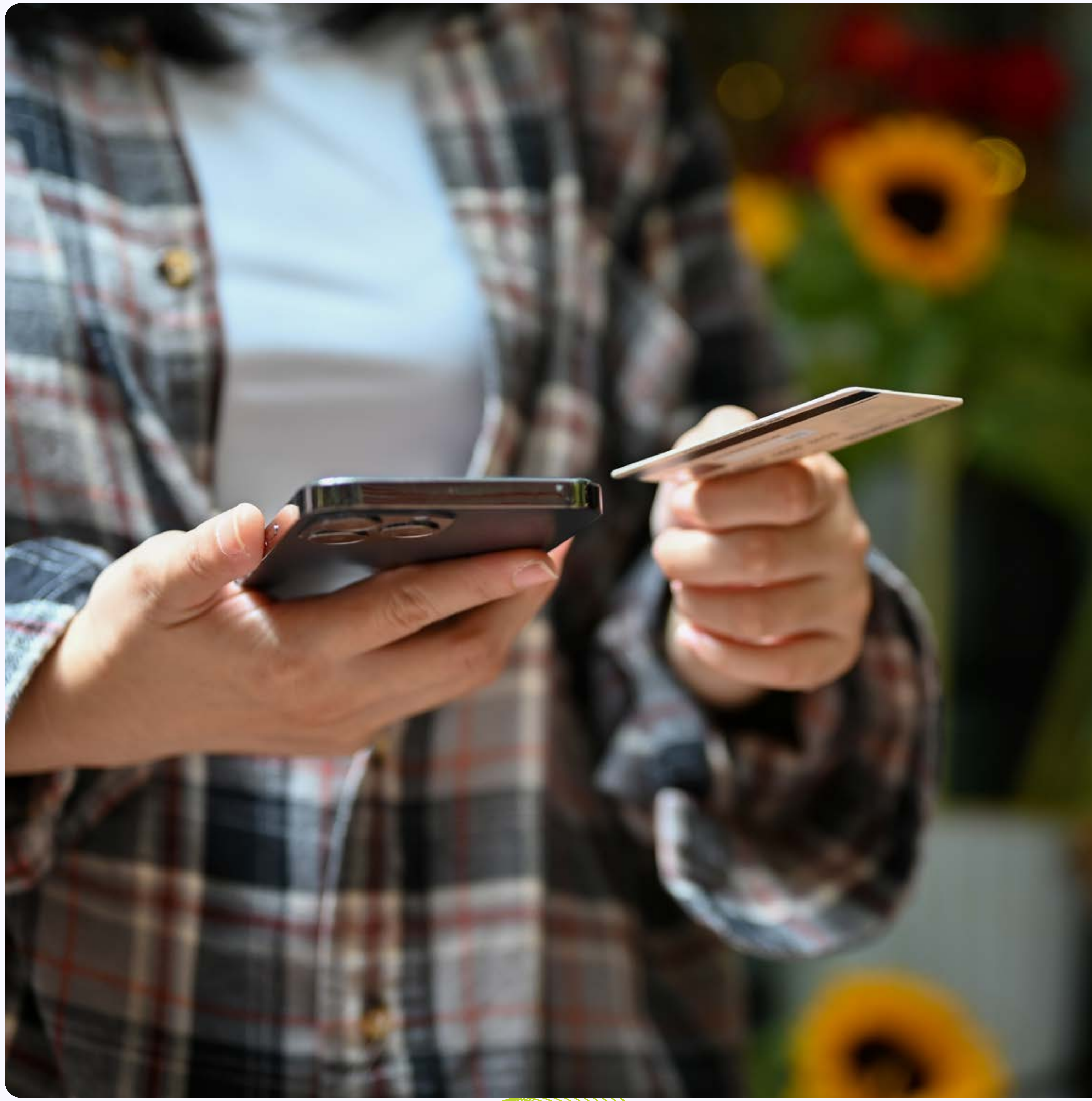
13%
Portion of CUs that classified themselves as early launchers of new products in Q4 2022

News and Trends

Credit Unions Navigate FedNow's Launch

The recent launch of the FedNow® Service instant payment system has been a game-changer for the financial industry, with dozens of FIs and companies implementing it in various capacities. Credit unions have been hesitant to implement instant payments rails previously, but FedNow's direct-to-Fed accounts have made this system much more appealing than what came before.

PSCU president and CEO Chuck Fagan said in a recent interview with PYMNTS that credit unions see instant payments rails as a way to create their own faster payments ecosystems, which would serve their consumer and corporate members. CU leaders in the same interview cautioned that faster payments may cannibalize some credit and debit spend, so CUs need to adjust their internal systems to account for this change.



News and Trends

CUNA predicts U.S. is likely to avoid recession

Looming fears of an economic recession have dominated corporate decision-making since the beginning of the pandemic, but some feel these fears may be misguided. The Credit Union National Association (CUNA) said that while interest rates are unlikely to ease anytime soon and savings growth will not meet expectations, it believes the U.S. will escape a recession.

CUNA noted that economic growth is slower than anticipated, however. Deposit growth was a disappointing 1.8% in Q1 2023 — a troubling development, considering that, on average, 60% of annual savings growth occurs during the first quarter.

“With our expectation that the Fed Funds rate will remain elevated for the full year, savings growth will remain weak, and the savings credit unions do attract and retain will be costly,” CUNA noted in a forecast report.

CUs increased credit card share in April

CU members are using credit cards more often in recent months, increasing CUs’ share of the overall credit market. A recent study found that CUs held $75.3 billion in credit card debt as of April 30, 2023, up 1.5% from March. This contrasts sharply with April figures from 2016 through 2022, which showed an average decline of 0.7%. This growth resulted in an overall credit card debt share of 6.4%, a small amount compared to banks’ share of 91.1%. Nevertheless, this shift, however slight, suggests a healthier economic forecast for CUs than banks.

6.4%
CU credit card debt share as of April 2023

6.3%
CU credit card debt share as of March 2023

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PYMNTS Intelligence

Why Credit Unions Are Merging to Sharpen Their Competitive Edge

The financial industry has become more competitive than ever as shifting economic conditions and the pandemic's lingering effects make digital banking the primary means by which consumers interact with their FIs. More than three-quarters of customer experience leaders in a recent survey said that demand for personalized services intensifies in times of financial crisis, which the U.S. has been teetering toward since the start of the pandemic.

CUs have traditionally relied on member relationships to compete with their larger cousins, but the shift to digital has made these relationships harder to maintain. This month's PYMNTS Intelligence examines why CUs are turning to mergers to pool their resources and survive in this rapidly changing environment.

PYMNTS Intelligence

Credit union mergers have been on the upswing in recent years in response to weak financial situations.

Q1 of 2023 alone saw 33 CU mergers approved by the National Credit Union Administration (NCUA), continuing a trend that has been growing ever since the pandemic began. Q3 2022 saw 58 mergers, for example, a significant growth compared to the 43 consolidations in the same quarter of 2021 and 34 during this time period in 2020.

The reasons for these mergers have varied by case, but a clear pattern of financial distress has emerged. Four of the Q3 2022 mergers were motivated by CUs' inability to obtain officials, three by poor financial conditions, two by unsustainable lack of growth, and one each by poor management and lack of sponsor support. All of these can be traced back to financial hardship of some degree.

CU mergers are quickly growing in number.

58

CU mergers in Q3 2022

43

CU mergers in Q3 2021

It is not just small community credit unions facing this hardship: Multistate organizations with billions of dollars in assets are also struggling. Q1 2023, for example, saw the $1.8 billion Northwest Community Credit Union in Oregon merge with the $2.2 billion Twinstar Credit Union in Washington state, as well as the merger of the $1 billion RTN Federal Credit Union and the $1.3 billion Merrimack Valley Federal Credit Union, both in Massachusetts. These institutions cited a need for expanded member services as their motive for joining forces.

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PYMNTS Intelligence

CUs’ efforts to compete through mergers are working well.

Federal Reserve Governor Michelle Bowman noted that regulators will need to reevaluate how they oversee CUs, as their traditional role as banking service providers for select groups of consumers is being blurred by the expansion of their member bases.

“Credit unions today are much more likely to compete directly with traditional banks offering the full ‘cluster’ of banking products and services than they did in 1995, which supports the argument that our analysis needs to give more weight to competition from credit unions,” Bowman said at the 2022 Community Banking Research Conference in St. Louis.

This concern from regulators highlights just how successful these CU mergers have been at meeting banks and FinTechs on a competitive level. If traditional FIs and regulators feel they have underestimated the competitive threat from CUs, then the CUs’ efforts are definitely working.

Mergers can help CUs gain the resources and expertise they need to deliver the digital banking experiences members increasingly demand.

Portion of CUs investing in innovative products such as real-time and peer-to-peer (P2P) payments in 2022

Portion of CUs investing in these innovative products in 2021

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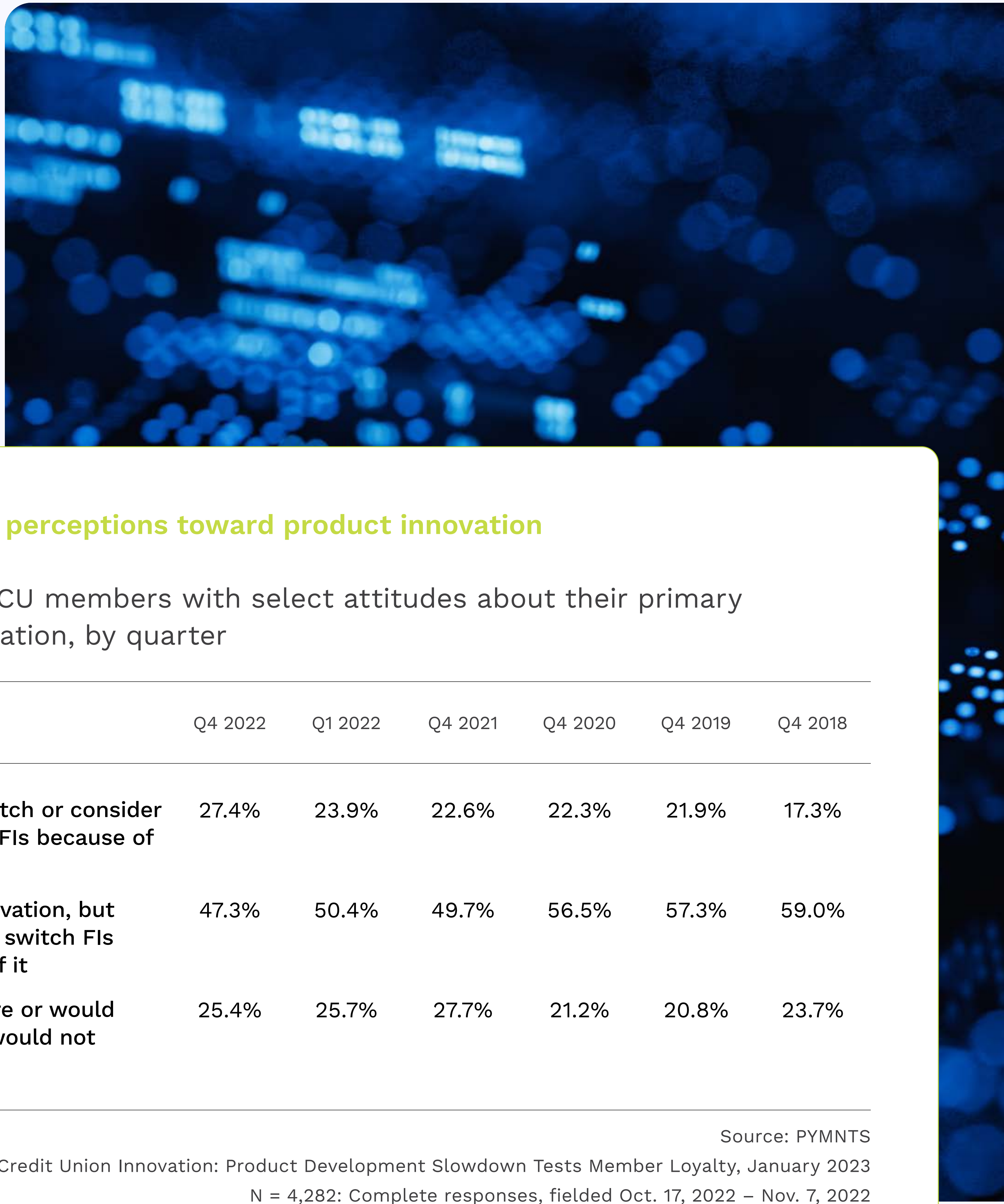
Chart of the Month

Product Innovation Could Persuade Many CU Members to Switch FIs

CU members are looking for the latest and greatest technology to augment their banking experiences, with just one-quarter of members saying in Q4 2022 that innovation is not an important factor for them. While 47% said they value it but would not switch FIs for it, 27% said they would consider changing FIs to access new products. This means that CUs risk losing more than one-quarter of their members if their products are anything less than first-rate, which can be a tall order for smaller CUs. This could be a major reason why CUs are exploring mergers and acquisitions: to gain the resources necessary to meet their members' product expectations.



Changing perceptions toward product innovation

Share of CU members with select attitudes about their primary FIs' innovation, by quarter

	Q4 2022	Q1 2022	Q4 2021	Q4 2020	Q4 2019	Q4 2018
• Would switch or consider switching FIs because of innovation	27.4%	23.9%	22.6%	22.3%	21.9%	17.3%
• Value innovation, but would not switch FIs because of it	47.3%	50.4%	49.7%	56.5%	57.3%	59.0%
• Do not care or would prefer FI would not innovate	25.4%	25.7%	27.7%	21.2%	20.8%	23.7%

Source: PYMNTS

Credit Union Innovation: Product Development Slowdown Tests Member Loyalty, January 2023

N = 4,282: Complete responses, fielded Oct. 17, 2022 – Nov. 7, 2022

Key Findings

01

MEMBERSHIP LOYALTY

Credit unions favor more personalized and member-focused services than their bank counterparts, and this appeal has formed a loyal membership base over the years.

136M

Total CU members in the U.S.

02

LIMITED RESOURCES

Banks and FinTechs have the resources and ability to deploy the digital programs consumers crave, putting CUs at a disadvantage.

49%

Share of CU executives for whom a lack of resources is preventing them from bringing innovations to market

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Key Findings

03

COMPETITIVE MERGERS

The shift to digital banking has made member relationships harder than ever to maintain, so CUs are merging with one another to pool their resources and survive in this rapidly changing environment.

58

CU mergers in Q3 2022

04

DIGITAL OFFERINGS

Mergers can help CUs gain the resources and expertise they need to deliver the digital banking experiences members increasingly demand.

60%

Portion of CUs investing in innovative products such as real-time and P2P payments in 2022

What's Next

Credit Unions Develop Data Capabilities

Member expectations are evolving fast, and credit unions are looking into ways to future-proof their industry by meeting members where they are. Data and connected experiences will be critical to meeting these expectations, according to PSCU's managing vice president of digital and data, Jeremiah Lotz. Understanding user patterns is essential to providing the digital experiences members demand, but many smaller CUs lack the capability to do so singlehandedly. Many CUs are exploring mergers with other CUs or partnering with FinTechs or credit union service organizations (CUSOs) to enable these data analytics and improve their member experiences.

"Through connected experiences, credit unions have an opportunity to drive growth utilizing all available member data and identifying how to enhance the overall relationship. Creating seamless, personalized experiences also helps build trust and encourages loyalty, positioning credit unions to compete effectively with big banks while maintaining that personal touch."

JEREMIAH LOTZ
Managing vice president of digital and data

PSCU

About

PYMNTS is where the best minds and the best content meet on the web to learn about "What's Next" in payments and commerce. Our interactive platform is reinventing the way in which companies in payments share relevant information about the initiatives that shape the future of this dynamic sector and make news. Our data and analytics team includes economists, data scientists and industry analysts who work with companies to measure and quantify the innovation that is at the cutting edge of this new world.

PSCU, the nation's premier payments CUSO and an integrated financial technology solutions provider, supports the success of more than 2,400 financial institutions and processes nearly 7.7 billion transactions annually. Committed to service excellence and focused on continuous innovation, PSCU's payment processing, fraud and risk management, data and analytics, digital banking, strategic consulting and real-time payments platforms, along with 24/7/365 member support via its contact centers, help deliver personalized, connected experiences. The origin of PSCU's model is collaboration and scale, and the company has leveraged its influence on behalf of credit unions and their members for more than 45 years. Today, PSCU provides an end-to-end, competitive advantage that enables credit unions to securely grow and meet evolving consumer demands. For more information, visit pscu.com.

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