CREDIT UNION INNOVATION

PLAYBOOK

Portfolio Leakage Edition

The Credit Union Innovation Playbook, a PYMNTS and PSCU collaboration, provides a big-picture analysis of the current state of credit union innovation in the United States. We surveyed a census-balanced panel of 5,239 U.S. consumers, 100 credit union decision-makers and 50 FinTech executives to learn which types of contactless payment innovations CU members would like their CUs to prioritize and discover whether credit unions are investing in these areas of interest.

PYMNTS.com | PSCU

AUGUST 2021

CREDIT UNION INNOVATION

PLAYBOOK

The Credit Union Innovation Playbook was done in collaboration with PSCU, and PYMNTS is grateful for the company's support and insight. PYMNTS.com retains full editorial control over the following findings, methodology and data analysis.

TABLE OF CONTENTS

PYMNTS.com | PSCU

INTRODUCTION

Pasadena-based Wescom Credit Union announced in July that it had been named the official banking partner of the University of California, Los Angeles (UCLA) Alumni Association. Wescom will be launching two new credit cards designed specifically for UCLA students, staff and alumni, 60 percent of whom currently reside in Southern California, where the credit union (CU) operates 24 branch locations. Cardholders will be able to earn customized rewards for purchases made at Rose Bowl Stadium and Pauley Pavilion when buying tickets through UCLA athletics and ordering food at Associated Students UCLA restaurants as well as select merchants located on the UCLA campus. Points can be redeemed for cash back, merchandise, special access to UCLA events and university game tickets or donations to select UCLA nonprofit organizations, to cite a few examples.

Wescom's new credit cards and offerings reflect the important role that cards play in credit unions' brands, member experiences and revenues. Credit cards are not only an important and potentially lucrative revenue stream, but they can also be foundational to a credit union's branded, regular touch points and relationships with members. Attractive credit card offers from other financial institutions (FIs) pose important brand and downside revenue risks to credit unions. PYMNTS' latest research reveals that 100 percent of CU executives say that losing credit card portfolios to competitors would have anywhere from a "very" to "extremely" detrimental impact on their revenues.

This so-called "portfolio leakage" problem is more widespread than many CUs might like to admit. Eighty-six percent of all members with credit cards who also use at least one other FI say that credit cards are one of the products they obtain from those FIs.

Credit cards are not the only financial product that members obtain from other FIs, either. Fifty-five percent of all credit union members obtain at least one financial product from financial institutions other than their primary CUs, underscoring just how widespread the issue of portfolio leakage is.

The Credit Union Innovation Playbook: Portfolio Leakage Edition, a PYMNTS and PSCU collaboration, explores the full extent of the portfolio leakage problem in the United States credit union sector.

We surveyed a census-balanced panel of 5,239 financial consumers from across the U.S. to quantify the number of financial products and services consumers use from institutions other than their primary FIs, which products they use and what percentage of members could be convinced to have their primary FIs be their sole providers of financial products and services. We also surveyed 100 decision-makers at credit unions throughout the U.S. to get an inside look at how portfolio leakage could impact credit unions' revenues and the types of new products and services CUs would be willing to innovate to keep their members from obtaining products from competitors.

This is what we learned.

FIFTY-FIVE PERCENT OF CREDIT UNION MEMBERS USE FINANCIAL PRODUCTS FROM OTHER FIs. **Forty-six percent of those who do so are using products from national banks.**

More than half of CU members use financial products obtained from FIs other than their primary CUs, and the share of those doing so is increasing. Fifty-five percent of members currently use at least one product or service from another FI, 2.4 percent more than did so last year. This increase may seem small, but it is partly driven by a significant share of members turning to other FIs for key financial instruments, including mortgages, business lines of credit and equity lines, among others. Eighty-four percent more members are obtaining second mortgages from other FIs this year than did so in 2020, for example. There are also 16 percent and 11 percent more members obtaining business lines of credit and home equity loans from other FIs, respectively, than did so in 2020. These financial products are among some of the most profitable for credit unions, meaning that portfolio leakage in these key areas could strike a harsh blow to CUs' profitability.

Many of the members who stray from their CUs to obtain financial products and services ultimately get those products from national banks. Forty-six percent of CU members who use financial products from other FIs obtain them from national banks — more than twice as many who do so from any other type of secondary FI. Online banks are a distant second, accounting for 20 percent of members who get financial products from other FIs. Nineteen percent of members who use other FIs' financial products obtain them from other credit unions, rounding out the top three.

CREDIT CARDS, FIRST-TIME HOME MORTGAGES, MORTGAGE REFINANCING AND AUTO LOANS PRESENT THE HIGHEST RISK FOR PORTFOLIO LEAKAGE. **These revenue-generating product offerings are the very ones that would have the greatest negative impact on CU performance.**

Foundational products, like credit cards, mortgages and auto loans, are the financial instruments CU members are most likely to source from other FIs, and the financial impact on CUs can be critical. One hundred percent of CUs that believe their members obtain credit cards from other FIs say that portfolio leakage would have a "very large" or "extreme" financial impact. Mortgages also pose a significant portfolio leakage risk. Sixty-three percent of CUs say that members taking out a first-time mortgage with another FI would have a "very" or "extremely" detrimental impact on their revenues, and that number climbs to 96 percent for mortgage refinancing. Many CUs also worry about the financial impact of having their members go elsewhere for auto loans. Eighty-five percent of CUs that believe their members are using auto loans obtained through other FIs say this type of portfolio leakage would have a "very" or "extremely" detrimental impact on their revenues.

These four financial products are among the top six most common ones members say they obtain through FIs other than their CUs. Eighty-six percent of members who hold credit cards and obtain at least one other financial offering from other FIs say that credit cards are one of those products. Among members who have taken out or refinanced a mortgage, 63 percent and 62 percent, respectively, say they do so with other FIs. Fifty-seven percent of members with auto loans who report using other FIs to obtain financial products and services state that auto loans are one of those products as well. This indicates that portfolio leakage not only is a pervasive problem but also has a significant negative impact on the very portfolios that are essential to CUs' revenues.

SOURCING ALL FINANCIAL PRODUCTS FROM THE SAME INSTITUTION IS "VERY" OR "EXTREMELY" IMPORTANT FOR 45 PERCENT OF ALL CU MEMBERS.

Banking with FIs other than their CUs is often not members' first choice. Forty-five percent would prefer to obtain financial products from a single institution, and even more would be willing to switch from obtaining products at secondary FIs if their CUs offered more innovative products. Forty-eight percent of CU members who hold credit cards from other FIs would switch those products over to their CUs if they innovated more effectively, for example. Our research shows that 48 percent of members who have taken out first mortgages with other FIs and 39 percent who have done so when refinancing mortgages would switch to offerings from their CUs if they could provide more innovative products.

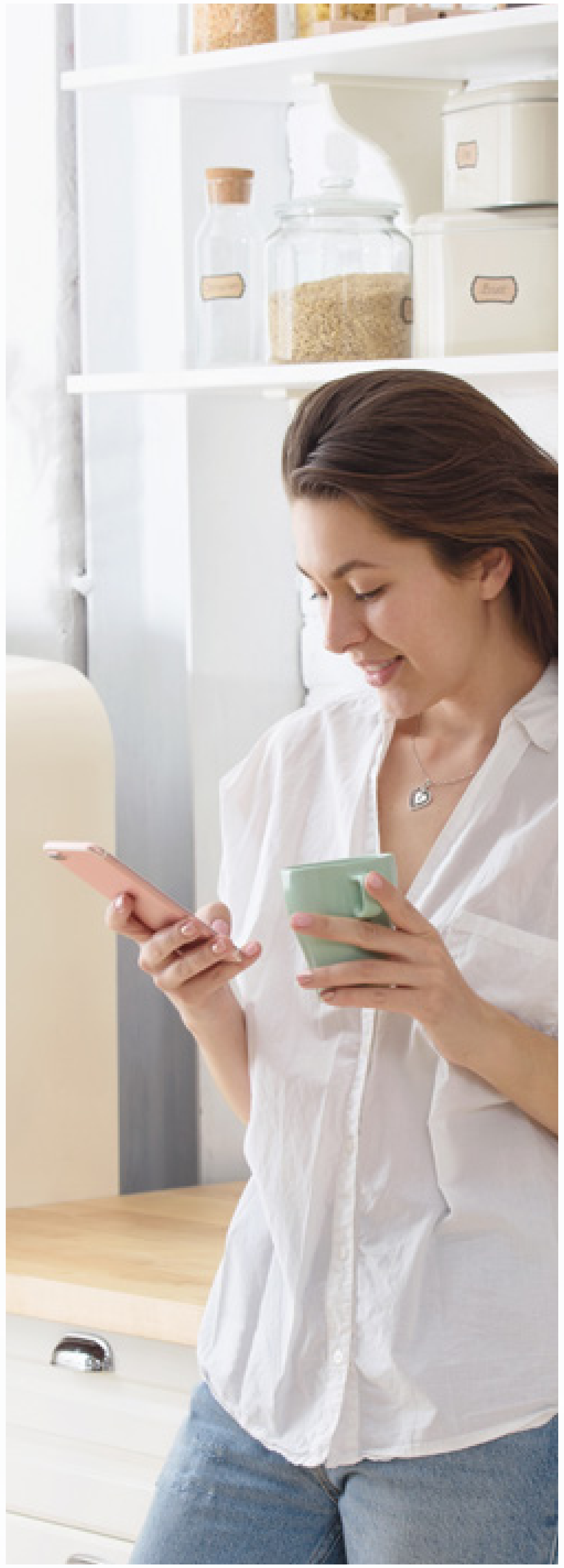
The trouble is that CUs are not always willing or able to innovate the products their members want most. The top four most common products and services on which CUs say they would focus their innovation efforts to retain members are personal loans, auto loans, credit cards and mortgage refinancing loans. One hundred percent of CU decision-makers who believe their members look to other FIs for personal loans, auto loans and credit cards would be "very" or "extremely" likely to innovate in these areas to retain members and prevent portfolio leakage, for example, and 59 percent of members would be "very" or "extremely" interested in obtaining personal loans from their CUs if they were offered. Eighty-one percent of CUs would be just as likely to innovate new mortgage refinancing services, while 38 percent of members would be willing to finance their mortgages through their current FIs if they innovated in this area.

CUs are less likely to say they would be willing to develop new, innovative ways to offer business lines of credit, second mortgage options and home equity loans, even though these are in higher demand among their members. Sixty percent of members would like to use their CUs for second mortgages, and 66 percent would be interested in obtaining business lines of credit through their CUs. Nevertheless, just 45 percent of CUs would be willing to innovate new business lines of credit products to mitigate portfolio leakage. There is also not a single CU in our sample that expressed willingness to innovate second mortgage products to retain members.

THIRTY-SIX PERCENT OF MEMBERS WOULD LEAVE THEIR CUs FOR FIs THAT CAN OFFER ALL THE FINANCIAL PRODUCTS THEY WANT.

Credit union members' desire to consolidate all their financial services in one place is both an opportunity and a liability. Thirty-six percent of all members would be at least "somewhat" likely to leave their CUs for competitors that offer all the financial products they want, in fact. This share is even higher among millennials and bridge millennials. Fifty-six percent of millennials and 52 percent of bridge millennials would be at least "somewhat" likely to leave in that instance.

This risk is not lost on credit unions. CUs are aware that their members would be willing to switch FIs, with 75 percent of CU decision-makers saying their members would be at least "somewhat" likely to leave for competitors that offer all the financial products they want. This is 82 percent more than the share who said the same in 2020, underscoring a growing awareness of the competitive risk. Addressing this gap could present CUs with an opportunity to serve their members, who value the more high-touch services they receive, and to fill an unmet market need.



CREDIT UNIONS UNDERESTIMATE THE IMPORTANCE THEIR MEMBERS PLACE ON PRICING. NINETY PERCENT OF CUs BELIEVE THAT THE PRIMARY REASON FOR PORTFOLIO LEAKAGE IS NOT HAVING THE PRODUCTS MEMBERS WANT.

Credit unions often misunderstand why their members turn to competitors. The most common reason CUs believe their members take their business elsewhere is because they do not offer the products their members want: 90 percent of CUs with members who source financial products from competitors say so. Credit unions are considerably less inclined to believe that members go elsewhere because CUs do not want to make the investment required to offer the products their members want or because other FIs' products are more convenient than their own. This belief is shared by 52 percent and 40 percent of CUs, respectively.

The truth is a bit more complicated. Members often get financial products from competitors not because they cannot obtain them from their primary CUs but rather because they can get the same products elsewhere at a lower cost. Twenty-eight percent of members who choose other FIs' products do so because interest rates are lower than those CUs offer, 16 percent say they do so because fees are lower and 24 percent do so because other FIs offer special plans for specific purchases. By contrast, only 25 percent of members who use other FIs' products say they do so because their own CUs do not offer them. This goes to show that mitigating portfolio leakage requires CUs to do more than offer the products their members want to use. They must also ensure that they offer those products at the competitive price points their members expect.

28%

of members who obtain financial products from FIs other than their primary CUs say it is because their CUs' competitors offer lower rates.

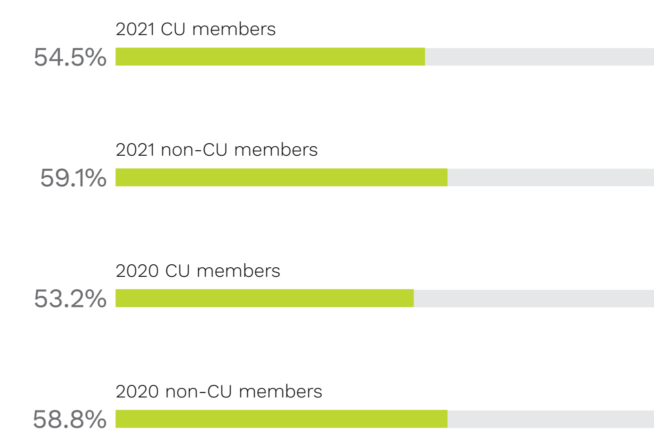
SCOPING THE COMPETITION

Portfolio leakage is a pervasive problem in the financial industry for both CUs and other FIs. Fifty-five percent of all credit union members obtain at least one financial product or service through an FI that is not their primary CU — 2.4 percent more than the share who did so in 2020 but less than is seen among consumers who bank with other types of FIs. Fifty-nine percent of consumers whose primary FIs are not credit unions (non-CU members) say they use at least one financial product or service from an institution other than their primary FI. Credit union members thus may be slightly less likely than non-CU members to obtain financial products from secondary FIs, but the majority are still using at least one product from one of their CUs' competitors.

National banks are by far the most common type of institution from which both CU members and non-CU members obtain products and services outside their primary FIs, but they are not CUs' only competition for portfolio originations. Forty-six percent of CU members and 50 percent of nonmembers who bank with two or more FIs use national banks in addition to their primary FIs. Online banks are a distant second, with 20 percent of CU members and 25 percent of non-CU members with multiple FIs saying they obtain at least one financial product through online banks. Local banks, regional banks, online lenders and technology firms make up the tail end of this ecosystem.

Figure 1:

How many consumers obtain products and services from secondary FIs
Share who obtain financial products from select institutions in addition to their primary FIs, members versus nonmembers



Source: PYMNTS | PSCU Credit Union Innovation Playbook

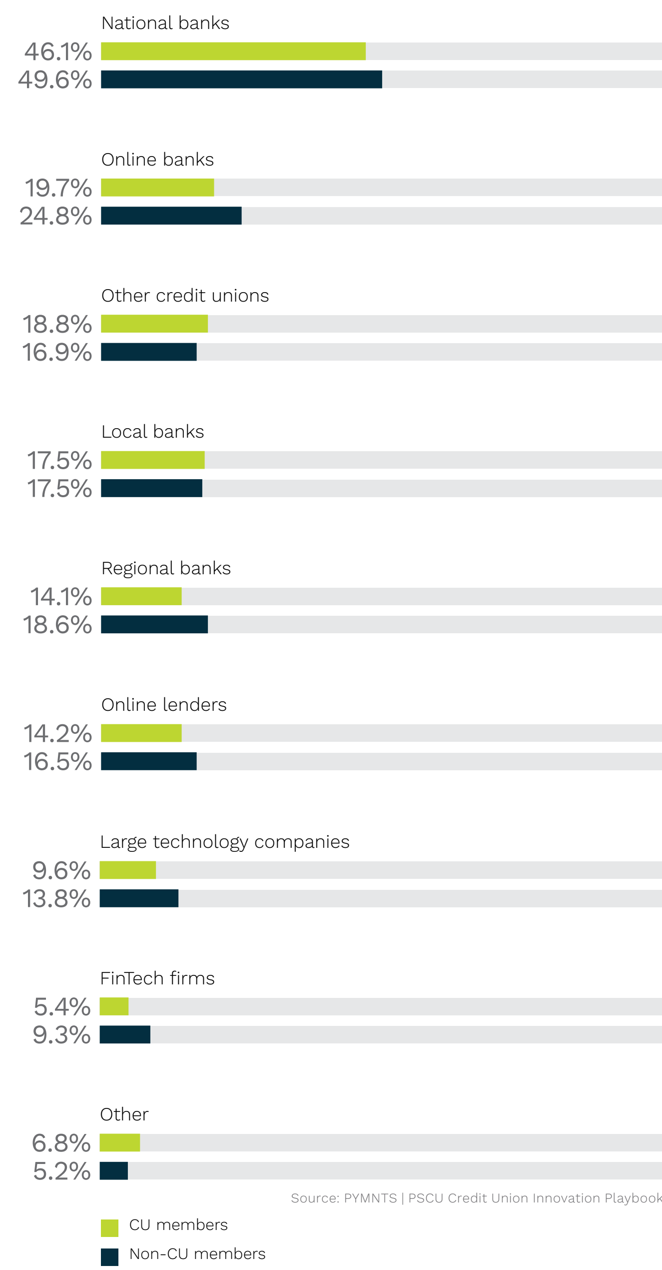
Not only do more than half of all members obtain financial products through secondary FIs, whether they be national banks, online banks or otherwise, but the products they acquire through those secondary FIs also tend to be those that have the most detrimental impacts on their primary CUs' revenues.

The four financial portfolios that CUs are most worried about losing to competitors are credit cards, first-time mortgages, mortgage refinancing and auto loans. One hundred percent of the credit unions in our study that believe their members obtain products from their competitors say that credit card portfolio leakage would have a "very" or "extremely" detrimental impact on their revenues, and 96 percent say the same about mortgage refinancing. Auto loan portfolio leakage is a concern as well, with 85 percent of CUs stating that their financial standing would be "very" or "extremely" impacted if their members obtained auto loans from competitors, and 63 percent of CU decision-makers say that their members getting first mortgages from competitors would have a similar financial impact.

Figure 2:

How many consumers obtain products and services from secondary FIs

Share who obtain financial products from select institutions in addition to their primary FIs, members versus nonmembers



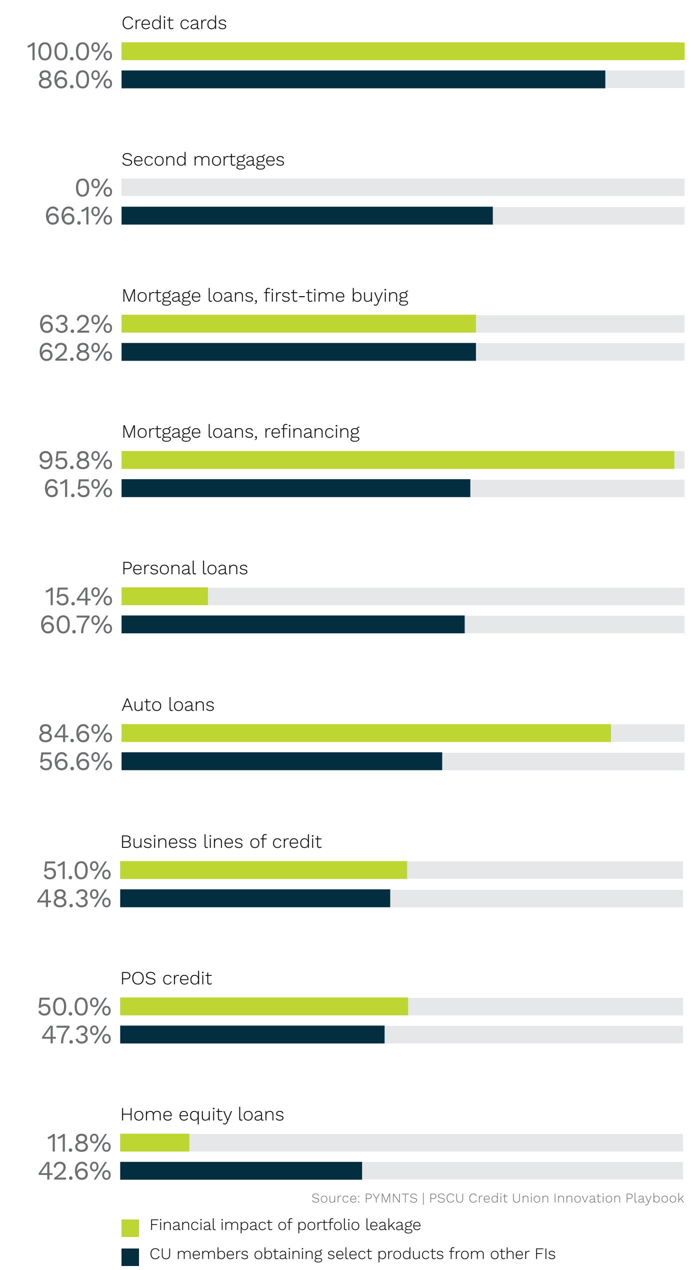
Each of these products are among the top six most common financial offerings that CU members obtain through institutions other than their primary FIs, with credit cards being the first. Eighty-six percent of CU members with credit cards who bank with other FIs have at least one credit card from their secondary FIs, representing a significant opportunity cost. PYMNTS data shows that 62 percent and 63 percent of members are either refinancing their mortgages or taking out their first mortgages through FIs other than their CUs, respectively, as well.

More credit union members are sourcing other financial services from competitors now than did so in 2020. The share of CU members taking out second mortgages through other FIs has jumped 84 percent in the past year, with 66 percent of members who use financial products from other FIs now citing second mortgages as one of those products. Portfolio leakage is also up for business lines of credit and home equity loans. The number of CU members seeking business lines of credit and home equity loans from other FIs has increased 16 percent and 11 percent, respectively, over 2020 levels.

Figure 3:

Which portfolios would have the greatest impacts on CUs' revenues if leaked

Share of CU decision-makers who believe portfolio leakage on select products would have "very large" or "extreme" impacts on their revenues



Our research also shows that CUs are growing more aware of this portfolio leakage problem, especially when it comes to their members' usage of other FIs to obtain personal, auto and home equity loans. Three times more credit union decision-makers say their members obtain personal loans from competitors now than did so in 2020. Two and a half times more say their members obtain auto loans from their competitors, and four times more say their members obtain home equity loans from other FIs. The only products that CU decision-makers are less likely to believe their members obtain from competitors now than in 2020, in fact, are second and first-time mortgages and point-of-sale (POS) credit.

Figure 4:

Which financial products and services consumers obtain from secondary FIs
Share of consumers who obtain select financial products from institutions other than their primary FIs, members versus credit union decision-makers

Source: PYMNTS | PSCU Credit Union Innovation Playbook

THE ALL-IN-ONE OPPORTUNITY

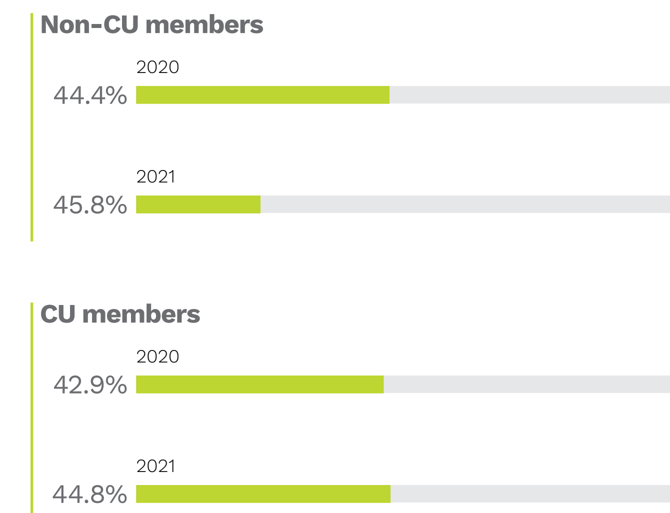
Most members may be banking with one or several institutions in addition to their primary CUs, but this is not necessarily by choice. Forty-five percent of members say that, all else being equal, they would prefer to get all their financial products from the same FI. This is just slightly more than the 43 percent of members who said the same in 2020 and slightly less than the 46 percent of non-CU members who share similar sentiments in 2021.

Members' preference for obtaining all their financial products from one FI presents a major opportunity for CUs to mitigate the financial impact of portfolio leakage. Innovation can help win these members over, but only if CUs can deliver the innovations their members want to use.

Forty-eight percent of members who currently use credit cards from other FIs would be willing to drop those FIs if their CUs offered more innovative credit cards, for example, and 49 percent of those who have taken out auto loans with secondary FIs would do the same for that product. This share is 59 percent for personal loans.

Credit unions appear to understand how important innovation is to winning members over and mitigating the portfolio leakage problem. One hundred percent of the CUs in our study would be willing to innovate credit card, auto loan and personal loan products if it meant persuading their members to use them for the financial products they currently get from competitors.

Figure 5:
How many consumers believe it is important to use the same FI for all financial products and services
Share of consumers who consider it either "very" or "extremely" important to obtain all financial products from the same institution



Source: PYMNTS | PSCU Credit Union Innovation Playbook

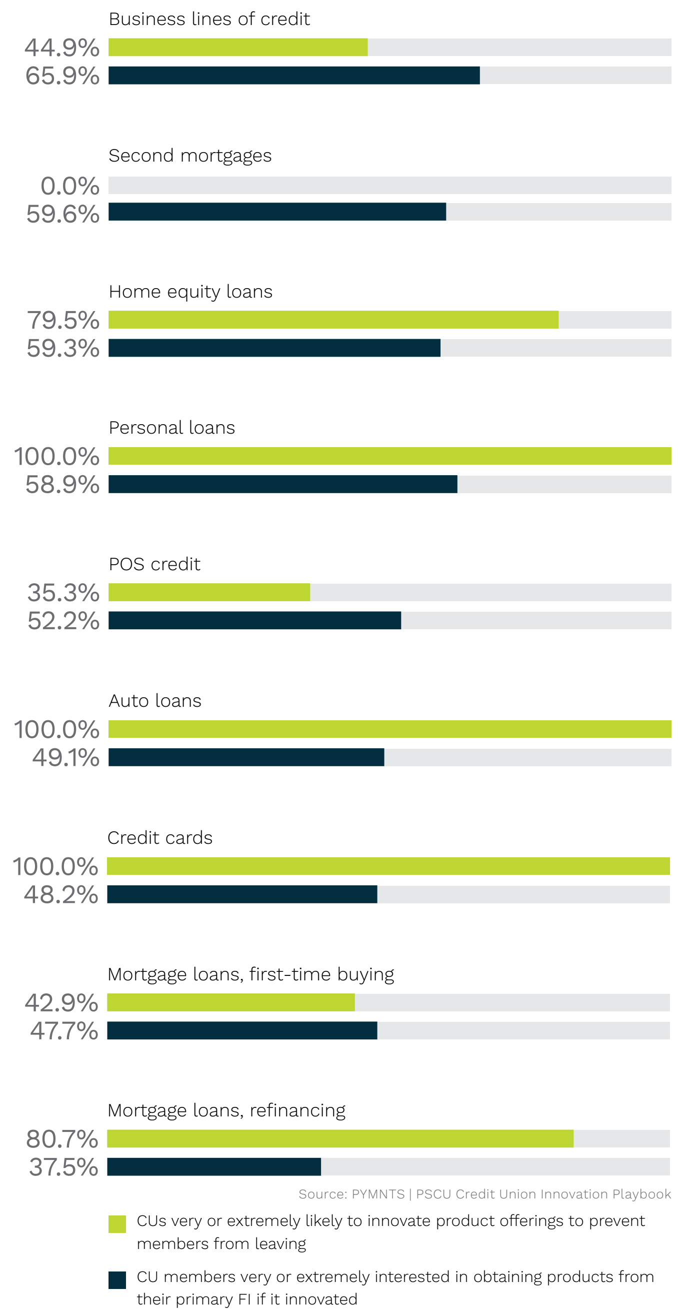
CUs' willingness to innovate does not always line up with members' interests, however. Home equity loans and mortgage refinancing services are high on the list of products that CUs would be willing to innovate to reduce portfolio leakage, but relatively few of their members would be willing to drop the equity loans and mortgage refinancing services they currently obtain from competitors. Eighty percent and 81 percent of credit union decision-makers say they would be willing to innovate new home equity products and mortgage refinancing products to mitigate portfolio leakage, respectively, but only 38 percent of the members who have taken out mortgage refinancing loans and 59 percent of members who have taken out home equity loans with other FIs would be willing to make the switch to obtain them from their CUs.

The opposite is true when it comes to business credit. Sixty-six percent of members who currently have business lines of credit with FIs other than their primary CUs say they would be willing to drop those business credit lines if their CUs could offer more innovative alternatives. Only 45 percent of CUs would be willing to innovate business credit products to alleviate portfolio leakage, however.

Members' desire to obtain all their financial products and services from the same FI can be both a blessing and a curse. Many members would just as soon leave

Figure 6:

How members' interest in new innovations compares to CUs' willingness to innovate
Share of consumers who would be "very" or "extremely" interested in obtaining select products and services through their primary FIs versus the share of CUs that would be willing to innovate them



their credit unions to bank with competitors that could offer them all the products they wanted as they would leave their secondary FIs to bank with their CUs exclusively. Thirty-six percent of all members say they would be at least "somewhat" likely to leave their CUs for FIs if it meant they could get all their financial products and services in one place — slightly more than the 35 percent who said the same in 2020.

Millennials and bridge millennials are even more likely than most to switch FIs for the opportunity to bank all in one place. Fifty-six percent of millennials and fifty-two percent of bridge millennial CU members would be at least "somewhat" likely to leave their CUs entirely if they could bank with competitors that offered all the financial products and services they want. Choosing the right innovations is therefore critical to gaining and retaining both millennial and bridge millennial members.

TABLE 1A:

How many consumers would switch FIs for all-in-one services Share of members who would leave their primary FIs for competitors if those competitors provided all the financial products they wanted, by date

CU Members	2020	2021
Not at all or slightly likely	65.2%	64.3%
Somewhat likely	21.2%	21.8%
Very or extremely likely	13.5%	13.9%

Source: PYMNTS | PSCU Credit Union Innovation Playbook

TABLE 1B: Share of members who would leave their primary FIs for competitors if those competitors provided all the financial products they wanted, by generation

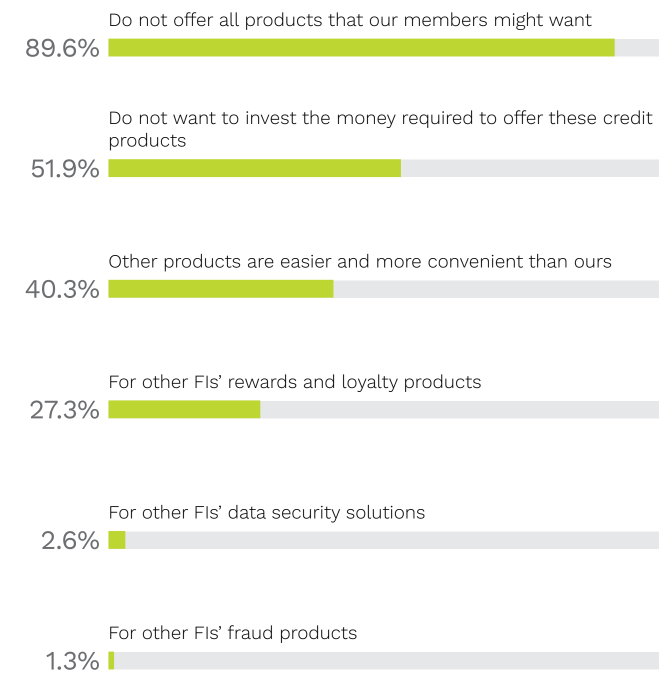
	Generation Z 24 or younger	Millennials 25 to 40	Bridge millennials 33 to 43	Generation X 41 to 56	Baby boomers/seniors 57 or older
Not at all or slightly likely	46.3%	44.4%	47.7%	65.6%	81.0%
Somewhat likely	36.0%	29.1%	25.0%	20.7%	14.7%
Very or extremely likely	17.7%	26.5%	27.4%	13.8%	4.3%

Source: PYMNTS | PSCU Credit Union Innovation Playbook

FIXING THE INNOVATION DISCONNECT

Figure 7:

Why CUs with members who obtain financial products from competitors believe their members do so
Share of CUs that believe their members go elsewhere to obtain credit products for select reasons



Source: PYMNTS | PSCU Credit Union Innovation Playbook

90%

of CU executives believe that their members use other FIs because they do not offer all the financial products their members want to use.

CUs appear to lack a clear understanding of their members' motives for banking at other FIs, which should be an essential basis for attacking the portfolio leakage problem. Nearly all credit union decision-makers believe that members bank with competitors to obtain products that they do not have access to at the CU. Ninety percent of CUs with members who obtain financial products from competitors believe this is at least one reason why their members seek out secondary FIs.

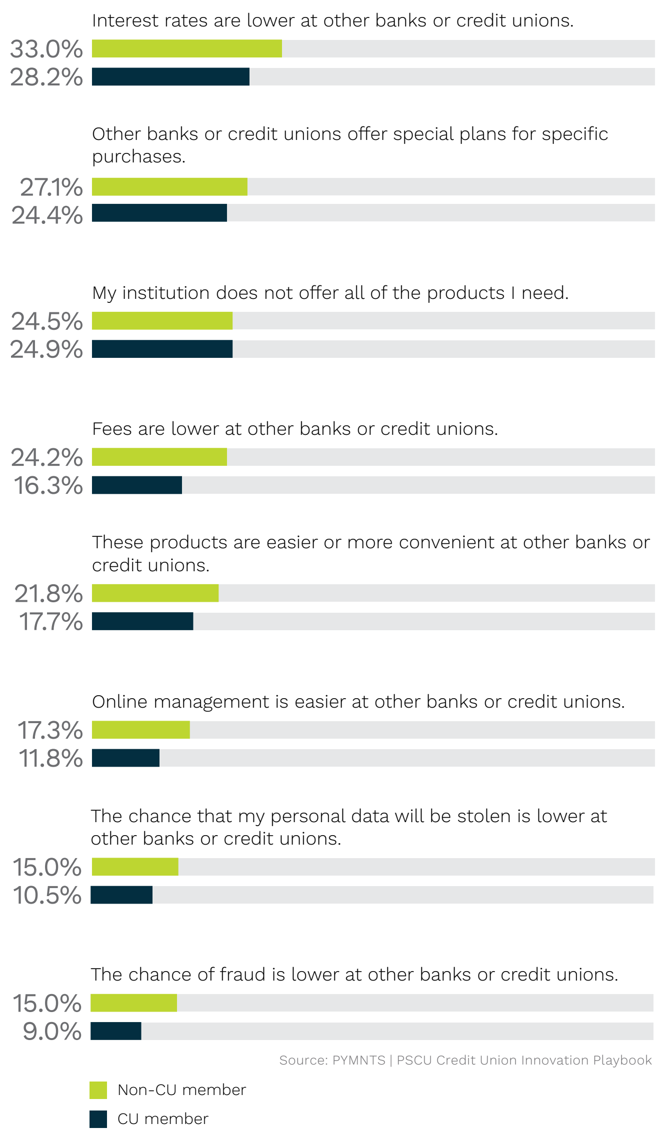
Fifty-two percent of credit union decision-makers believe their members use secondary FIs when their CUs are unwilling to invest the money required to provide their desired products. The third-most common reason why CU decision-makers believe their members seek financial products from competitors pertains to access.

It is true that many CU members use secondary FIs when they cannot obtain the products they want from their credit unions, but even more use their CUs' competitors because of cost concerns. More members cite lower interest rates as a reason for banking with FIs other than their credit unions than any other factor at 28 percent.

Figure 8:

Why consumers obtain financial products and services from secondary FIs

Share of consumers who cite select reasons for using financial products and services from secondary FIs, members versus nonmembers



Concerns over costs are also related to the second- and fourth-most common factors that drive members to bank with their CUs' competitors. Twenty-four percent of members who obtain at least one product or service from other FIs say they do so because other banks and CUs offer special plans for the specific purchases they want to make, and 16 percent say they use other FIs because their fees are lower. This makes for a total of 54 percent of all CU members using other FIs' products partly because of cost. Only 25 percent of CU members who use other FIs' products do so because they cannot obtain those products from their primary CUs, by comparison.

Convenience is another factor that members have in mind when deciding to bank with FIs other than their primary CUs. Eighteen percent of those who do so say they believe other FIs offer more convenient products, and 12 percent say that other FIs make it easier to manage their accounts online.

Even worries about data security can drive members to bank with other FIs. Eleven percent of members use products from other FIs because they believe the chances of their data being stolen are lower with other FIs, and 9 percent do so because they believe the risk of fraud is lower.

The fact that credit union members give such a wide variety of reasons for choosing to use products from their CUs' competitors indicates that it is not enough for credit unions to simply offer the products that their members want to use. CUs must also ensure that those products are up to their members' expectations in terms of cost, convenience and data security.

CREDIT UNION INNOVATION PLAYBOOK

CONCLUSION

Credit unions are slowly coming to realize the full extent of portfolio leakage's impact on their financial well-being, with more CU executives than ever expressing concerns that their members are looking to competitors to get important financial products and services. Many of these CUs are hoping that innovation can help curb this problem, but doing so requires CUs to have a firm understanding of what draws their members to bank with competitors in the first place. The real driver of portfolio leakage is not CUs' lack of product offerings but rather the fact that their products are often more expensive than their competitors'. Credit unions must be able to innovate products that meet members' needs for cost-effective, convenient, easy-to-use and secure financial services at all points across the member life cycle. Only then can CUs fully address the risk of portfolio leakage.

METHODOLOGY

The Credit Union Innovation Playbook, a PYMNTS and PSCU collaboration, draws from a three-tiered survey of 5,239 U.S. consumers, 100 credit union decision-makers and 50 FinTech executives conducted between April 26 and May 24, 2021. Respondents for our U.S. consumer survey were census-balanced. Respondents' average age was 47 years old. Thirty-two percent had college degrees, 52 percent were female and 36 percent earned more than $100,000 in annual income.

ABOUT

PYMNTS.com

PYMNTS.com 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

PSCU, the nation's premier payments CUSO, supports the success of 1,500 credit unions representing more than 5.4 billion transactions annually. Committed to service excellence and focused on innovation, PSCU's payment processing, risk management, data and analytics, loyalty programs, digital banking, marketing, strategic consulting and mobile platforms help deliver possibilities and seamless member experiences. Comprehensive, 24/7 year-round member support is provided by contact centers located throughout the United States. 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 40 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.

We are interested in your feedback on this report. If you have questions, comments or would like to subscribe, please email us at feedback@pymnts.com.