

# G| Glatt Consulting

## Credit Union Industry HealthScore Report

**G| Glatt Consulting**

PO Box 7957, Wilmington, NC 28406 | (888) 217-5988 | [www.glattconsulting.com](http://www.glattconsulting.com)

HealthScore report for quarter ending 12/31/2015

**Please direct questions to:**

PO Box 7957, Wilmington NC 28406  
(888) 217-5988  
healthscore@glattconsulting.com

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Distinctive strategy consulting for credit unions

# G | In This Report

**HealthScore Trends** - This section highlights the HealthScore trends for the credit union community, including trends for the overall score and for year-over-year percent changes in score. Also in this section is a chart illustrating a breakdown of current component scores. The data in this section is helpful in developing an understanding of credit union health, and also of the driving forces influencing health - both positive and negative.

**Score Change Breakdown** - This section illustrates the year-over-year percent change in the overall HealthScore as well as the component scores. Score change data is presented in a color-coded form for easier visual indication of areas of improving health and/or growing weaknesses.

**Industry Leaders & Movers** - This section highlights the 12 credit unions across the industry with the highest overall HealthScores, and also the 12 credit unions with the largest year-over-year HealthScore improvement.

# G | About This Report

This report is designed to provide you unique insight into the health of the credit union community. We hope you will find this report helpful in identifying (and perhaps further researching) broad industry health trends, and also credit unions that are doing well by industry standards.

## **HealthScore Creation And Use**

The HealthScore was an outcome of a Glatt Consulting client merger project. In 2008, during the depths of the Great Recession, we were asked by a client greatly impacted by the recession to help them quickly identify and rank the overall “health” of potential merger candidates. Their desire was to find a partner healthy enough to take on the challenges of the credit union's increasingly risky balance sheet, and that could continue to provide good service to the credit union's members. We created a rudimentary scoring system that allowed us to determine the relative health of potential partners, and to rank their "fit" given the credit union's objectives.

Following completion of the project we worked to refine the scoring methodology and process, and then began releasing our score calculations for industry use. To-date the HealthScore has been used to support the development of credit union merger strategy, as a reference tool for client strategy planning and assessment, for CEO performance evaluation criteria, competitor evaluation and tracking, and for market assessment.

### **HealthScore Scoring Methodology**

To arrive at a credit union's HealthScore, and an overall industry HealthScore, we first score/grade individual credit union performance for each of 17 different credit union ratios:

- |  |   |
|--|---|
| 1. Net Worth                                 | 10. Regular Shares to Total Shares and Borrowings |
| 2. Solvency Evaluation                       | 11. Loans to Assets                               |
| 3. Return on Average Assets                  | 12. Loans Per Member                              |
| 4. Operating Expenses to Average Assets      | 13. Deposits Per Member                           |
| 5. Efficiency                                | 14. Borrowers Per Members                         |
| 6. Delinquent Loans to Total Loans           | 15. Asset Growth                                  |
| 7. Net Charge-Offs to Average Loans          | 16. Loan Growth                                   |
| 8. Texas                                     | 17. Membership Growth                             |
| 9. Cash and Short-Term Investments to Assets |   |

Grading is based on a 10-point scale, with 0 reflecting poor health and 10 reflecting exceptional health. Individual "component" scores are then averaged to determine a credit union's overall HealthScore. General industry health is calculated and tracked by averaging individual credit union HealthScores.

These ratios included in the HealthScore were selected for their strong correlation to sound credit union performance. Visit <http://www.glatconsulting/HealthScore> for more detailed information on the analysis used to determine which ratios to incorporate into the HealthScore system, and the establishment of the score scale.

### **Score Components and Chart Abbreviations Key**

The ratio components of the HealthScore system are further described below. Note that each ratio's name is followed by an abbreviation (e.g., Net Worth followed by "NW"). These abbreviations are used throughout the report.

**Net Worth (NW):** This ratio measures net worth in relation to total assets. Net worth cushions fluctuations in earnings, supports growth, and provides protection against insolvency. A low Net Worth (NW) score may indicate insufficient net worth. A high score, though generally positive, may indicate limited commitment to cooperative principles.

**Solvency Evaluation (SE):** This ratio measures the value of assets after liabilities in relation to shares. A low Solvency Evaluation (SE) score may indicate risk of insolvency (the credit union can no longer meet its financial obligations) and/or a high likelihood of regulator administrative action. A high score, though generally positive, may indicate limited commitment to cooperative principles.

**Return on Average Assets (RA):** This ratio measures net income in relation to average assets. A low Return on Average Assets (RA) score may indicate that earnings do not properly cover the credit union's operating expenses and cost of funds. A high score, though generally positive, may indicate limited commitment to cooperative principles.

**Operating Expenses to Average Assets (OE):** This ratio measures effectiveness in controlling the costs of operations. A low Operating Expenses to Average Assets (OE) score may indicate a need to reduce or better control operating expenses. A high score, though generally positive, may indicate lack of necessary investment in operations.

**Efficiency (EF):** This ratio measures the relationship between income and expense. A low Efficiency (EF) score may indicate a need to improve earnings and/or better control expenses. A high score, though generally positive, may indicate a lack of necessary investment in operations and/or limited commitment to cooperative principles.

**Delinquent Loans to Total Loans (DL):** This ratio measures the effectiveness of delinquency control and the quality of loans held in portfolio. A low Delinquent Loans to Total Loans (DL) score may indicate a high degree of portfolio risk and/or a need for increased provision for loan losses. A high score, though generally positive, may indicate overly restrictive underwriting policy.

**Net Charge-Offs to Average Loans (CO):** This ratio is an indicator of the effectiveness of lending and collection practices. A low Net Charge-Offs to Average Loans (CO) score may indicate a high level of uncollectable loans and/or a need for improvement in collection strategy and effort.

**Texas (TX):** This ratio measures the total value of at-risk loans in relation to the total value of funds on hand to cover such loans (allowance for loan losses and capital). A low Texas (TX) score may indicate an inability to absorb losses and/or a high likelihood of institutional failure.

**Cash and Short-Term Investments to Assets (CA):** This ratio is an indicator of the level of cash and liquid assets available to meet share withdrawals or additional loan demand. A low Cash and Short-Term Investments to Assets (CA) score may indicate the credit union will be unable to meet current obligations. A high score, though generally positive, may indicate stress on income due to lack of yield.

**Regular Shares to Total Shares and Borrowings (RS):** This ratio measures liquidity, specifically the portion of funding sources derived from regular (core) shares. A low Regular Shares to Total Shares and Borrowings (RB) score may indicate liquidity stress and/or that the credit union is overly reliant on price-sensitive funds. A high score, though generally positive, may indicate excessive liquidity.

**Loans to Assets (LA):** This ratio measures liquidity and also the effectiveness of member loan relationship development. A low Loans to Assets (LA) score may indicate earnings stress and/or lack of lending relationships. A high score, though generally positive, may indicate liquidity stress.

**Loans Per Member (LN):** This ratio measures average per-member loan relationships. A low Loans Per Member (LN) score may indicate lack of focus on loan relationship development and/or a need for membership diversification. A high score, though generally positive, may indicate excessive member debt loads, overly accommodative underwriting policy, or a high concentration of large dollar loans (e.g., real estate).

**Deposits Per Member (DE):** This ratio measures average per-member deposit relationships. A low Deposits Per Member (DE) score may indicate lack of focus on deposit relationship development and/or a need for membership diversification.

**Borrowers Per Members (BM):** This ratio measures the number of borrowers relative to overall membership. A low Borrowers Per Members (BM) score may indicate a need for improved loan sales and marketing strategy and/or membership diversification.

**Asset Growth (AG):** This ratio measures growth in total assets. A low Asset Growth (AG) score may indicate lack of focus on member relationship development and/or a need for membership diversification/field of membership expansion. A high score, though generally positive, may indicate unsustainable growth.

**Loan Growth (LG):** This ratio measures growth in total loans. A low Loan Growth (LG) score may indicate lack of focus on member relationship development and/or a need for membership diversification/field of membership expansion. A high score, though generally positive, may indicate unsustainable growth and/or overly accommodative underwriting policy.

**Membership Growth (MG):** This ratio measures growth in total membership. A low Membership Growth (MG) score may indicate lack of focus on developing relationships within the field of membership and/or a need for field of membership expansion. A high score, though generally positive, may indicate a need to purge dormant or inactive member accounts.

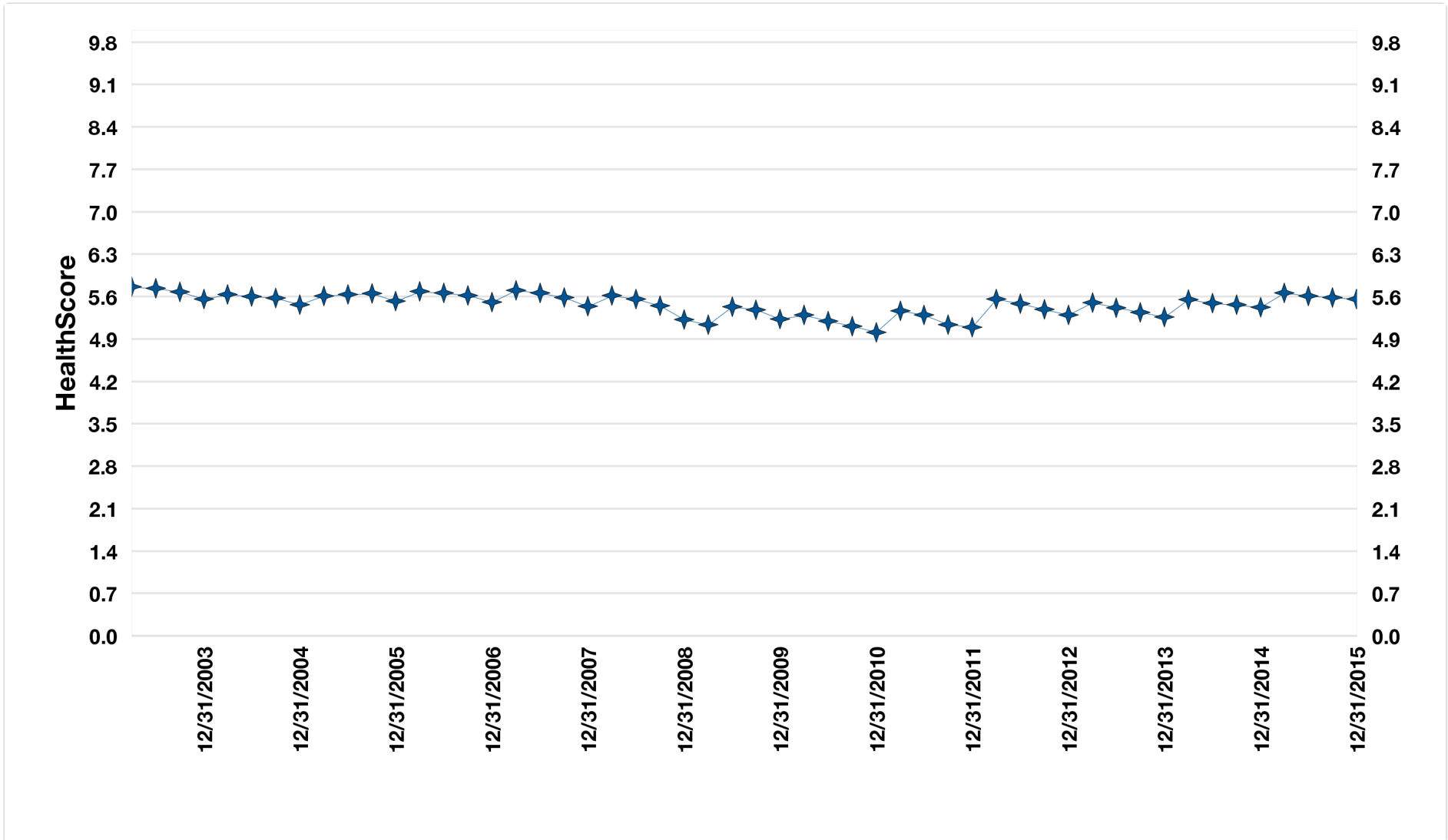


# Credit Union Industry Health Score Trends

This section highlights industry HealthScore trends, including trends for the overall HealthScore and for year-over-year percent changes in score. Also in this section is a chart illustrating a breakdown of current component scores. Data in this section is helpful in developing an understanding of credit union health, and also of the driving forces influencing health - both positive and negative.

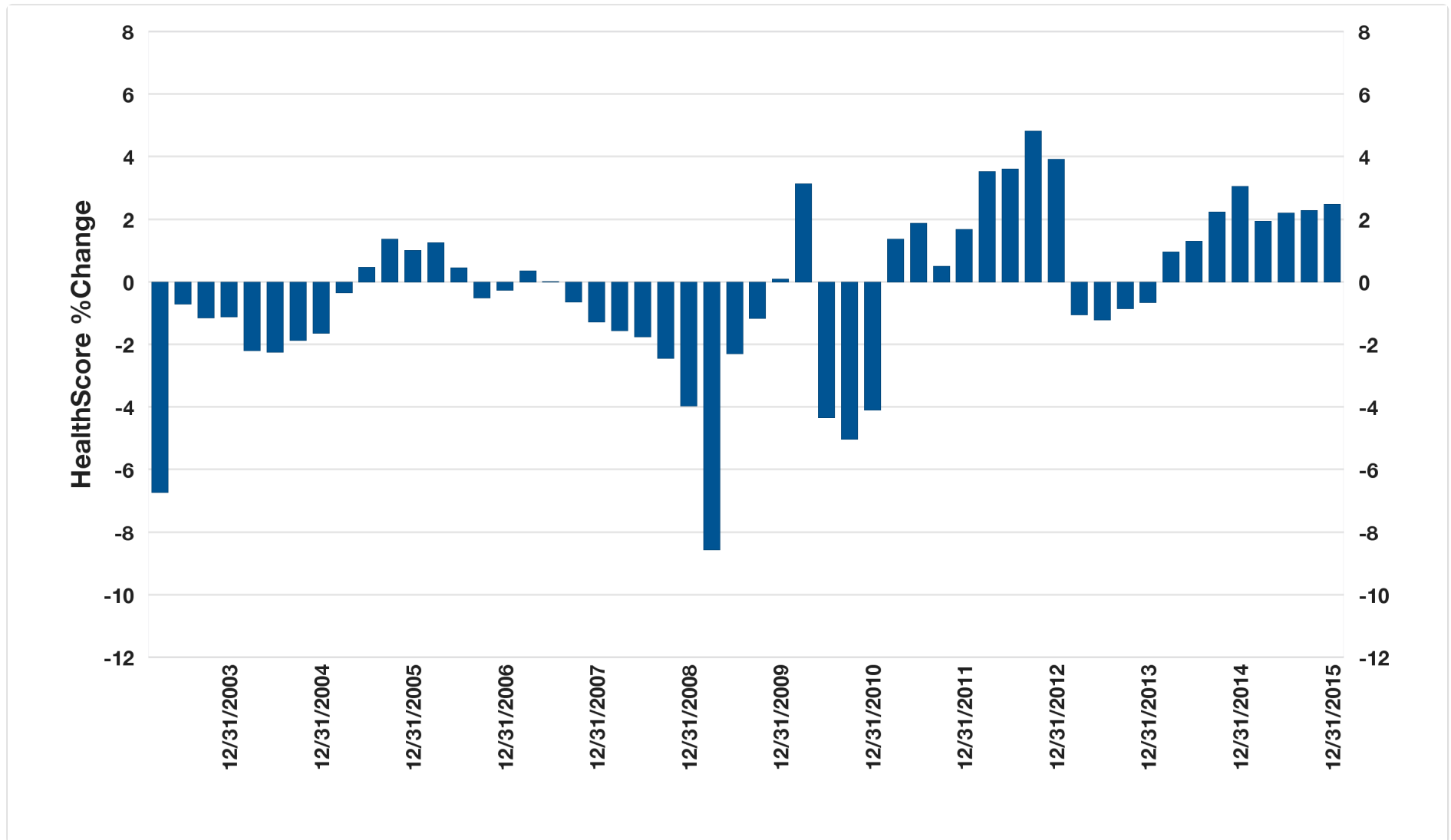
# HealthScore Trend

The chart below tracks the overall industry HealthScore. Seasonal factors and common credit union practices, such as purging dormant accounts, have a noticeable impact on scores over the course of any given year.



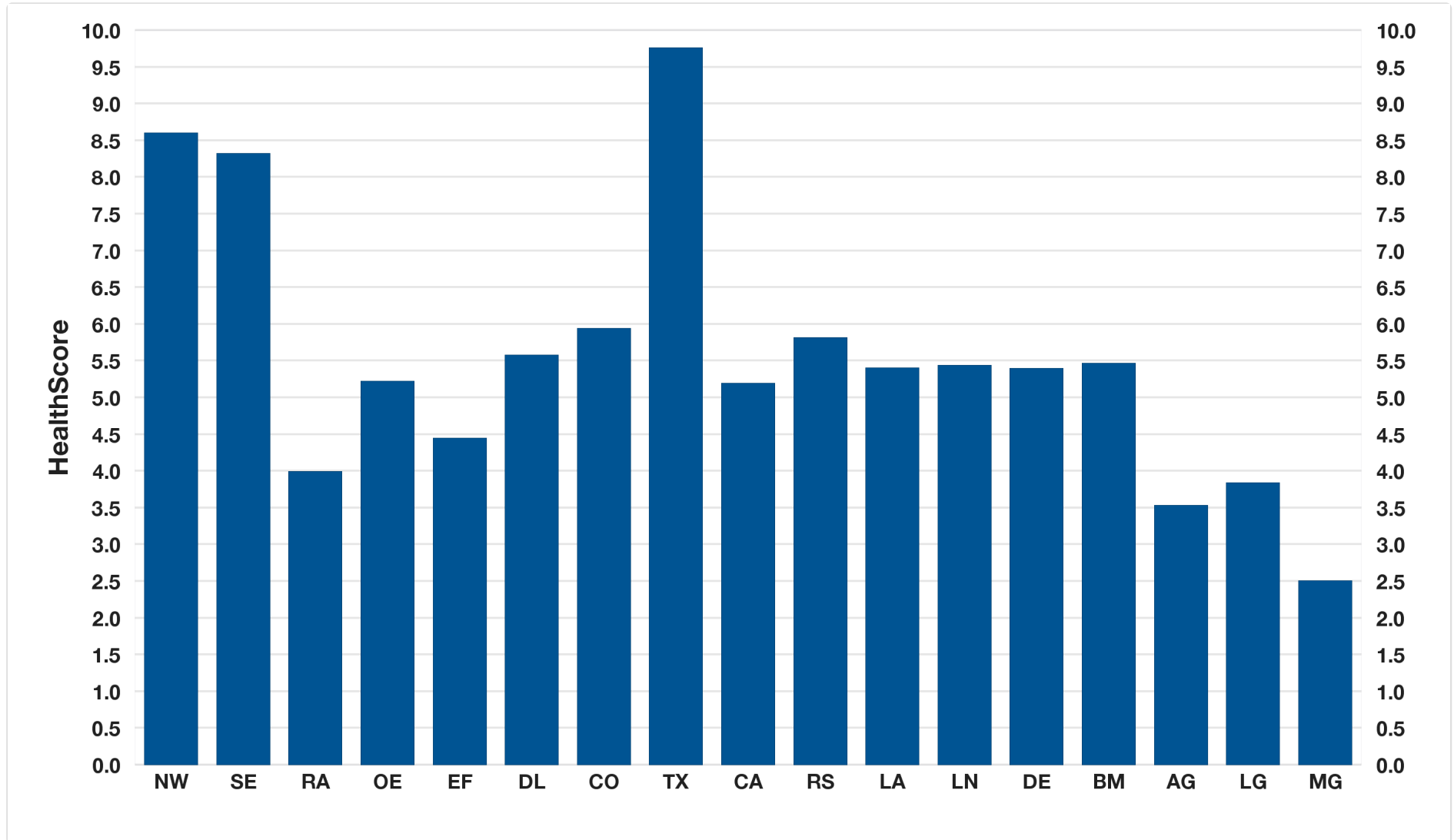
## HealthScore Year-Over-Year %Change

The chart below tracks the year-over-year percent change in industry health, indicating the general direction in which the industry is headed. Improvements in health are reflected in positive year-over-year changes while declining health is reflected in negative changes.



## Component Score Breakdown

The chart below illustrates the current breakdown in the component scores making up the HealthScore. Recall that the HealthScore scale is from 0 to 10, with 10 meaning extremely healthy. Low scores for any given component indicates potential industry weaknesses.



# HealthScore Change Trends

The table on the following page illustrates the year-over-year percent change in the overall HealthScore as well as the component scores. The table is color-coded for easier visual indication of emerging industry health or growing weaknesses. Green indicates improving health. Yellow indicates little change in health, and could be a harbinger of pending problems depending on the underlying trends in year-over-year score changes. Red indicates declining health.

The chart on the preceding page and the table on the following page can be compared against one another to determine whether underlying trends illustrated in the table are of major concern.