2017-2018 Credit Union Investment Services Study

Trends from the Annual Credit Union Retail Investment Services Benchmarking Survey

Authors: Ken Kehrer, PhD, and Tim Kehrer

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KEHRER BIELAN RESEARCH & CONSULTING

Sponsored by:

LPL Financial

To better understand how investment services are being delivered through credit unions and to identify best practices, Kehrer Bielan Research & Consulting surveys credit unions each year for detailed information on their investment services businesses.

The 2017-2018 Kehrer Bielan Credit Union Investment Services Benchmarking Survey was conducted during the first half of 2018. Financial data cover calendar year 2017. The 2017-2018 survey encompasses 76 credit unions which collectively employ 689 financial advisors—a record level of participation.

A complete list of participating credit unions can be found in the appendix.

Kehrer Bielan would like to thank LPL Financial for its support of this important research.

IMPORTANT YEAR-OVER-YEAR METRICS FOR CREDIT UNIONS

Making the Investment

Credit unions added financial advisors at a breakneck pace in 2017. The number of advisors working in credit unions jumped by nearly one-quarter year over year, a stunning accomplishment and a sign that credit unions are embracing investment services like never before.

Growth in advisor headcount contributed to revenue growth, as credit unions operated with a greater number of revenue producers, on average. But gross revenue (GDC) grew much more slowly than headcount (Fig. 1).

Why? Because advisors new to the firm take time to ramp up their production and can be a drag on some performance measures in the short term. The rapid addition of advisors made the impact of this phenomenon particularly acute in 2017.

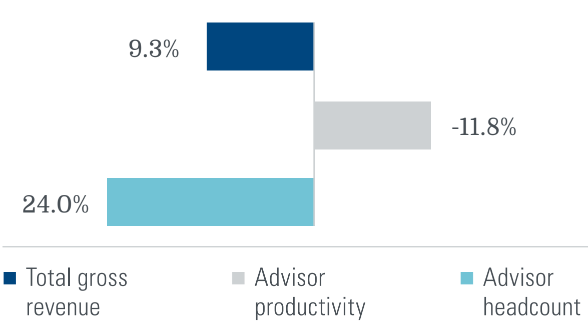
Average advisor productivity declined 12% year over year, as advisors still in their ramp-up phase produced less, on average, than more tenured advisors.

The addition of advisors also contributed to lower profit margins, as advisors new to the firm are not as profitable in their first year. Median net income contribution margin, which we define as revenue minus direct and allocated expenses before any credit union enterprise G&A allocation, narrowed to 19% in 2017 (Fig. 2).

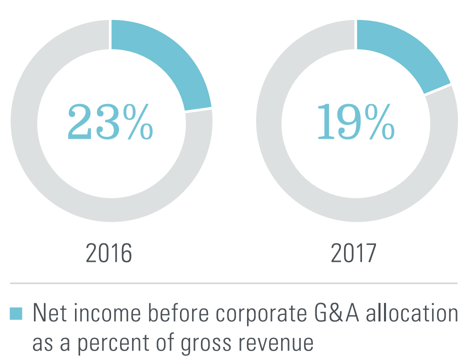
Of course, profit margins were also impacted by fee compression, lower commission rates on some transaction products, and the shift to fee-based advisory business.

The impact of adding advisors on margin and average productivity are common barriers to growing headcount. The credit unions that increased headcount in 2017 may

1. Trends in Credit Union Investment Services: 2017 vs. 2016



2. Net Income Contribution Margin (median)



now find themselves second-guessing the strategy. But they would do well to remember that the addition of advisors in 2017 will help future years' revenue, profit contribution, and member penetration. Already the addition of new advisors provided a boost to member penetration, which improved by 18% to 2.6% in 2017 (Fig. 3).

To capitalize on the full potential of their beefed-up sales force, credit unions should focus on, and invest in, keeping their new advisors through the ramp-up period and into maturity.

Where Have All the Referrals Gone?

Another challenge facing these credit unions is the steep drop-off in referral volume from credit union staff to the investment services unit.

Branch traffic has been dwindling precipitously and is unlikely to recover as younger generations are less likely to visit a branch and all generations are doing more of their financial business online, via mobile app, and over the phone.

The typical advisor working in a credit union received just 171 referrals in 2017, down 23% from the previous year (Fig. 4).

For current or would-be financial advisors, the credit-union-as-referral-source has been the key factor differentiating the credit union securities and insurance community from other sources of financial advice.

Barely more than 1% of credit union households were referred to the brokerage unit in 2017. Two decades ago, household referral penetration exceeded 2% (Fig. 5).

From this view, plummeting branch referrals might look like an existential crisis. Credit unions need to mine alternatives like their digital platforms and call centers for leads for their across-the-desk advisors in order to preserve the value proposition of being affiliated with a financial institution. And credit union advisors need to dig deeper into their existing books of business for opportunities to capture more assets, and expand client relationships.

Penetration of the Opportunity

Since the core objective of credit unions offering investment services is to serve the investment needs of their members, we use the size of the credit union as the yardstick to measure their penetration of their opportunity.

In 2017, credit unions saw revenue penetration of share deposits increase 4% to $1,299 per million, rebounding from a drop in penetration during 2016, when the growth in credit union share deposits outpaced investment services revenue growth (Fig. 6). Credit unions are already experiencing the gains in revenue from increasing the number of advisors they deploy.

Advisor Payout

The average effective advisor payout rate in credit unions, which we define as total advisor compensation divided by total advisor-produced revenue, increased to 42%, after dipping during 2016 (Fig. 7).

Total Advisor Compensation / Total Advisor Produced Revenue = Effective Advisor Payout Rate

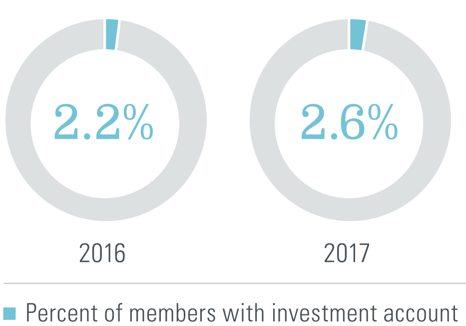
The effective payout rate takes into account the impact of some advisors not making their draw, special incentives for life insurance, advisory business, and longevity, and qualitative bonuses. Consequently, the effective payout can be higher than the top payout in the advisor's grid.

The surge in new advisors probably contributed to an increase in the average payout rate, because newly minted advisors are often given a high payout rate during the first year of their tenure to help them get their legs under them.

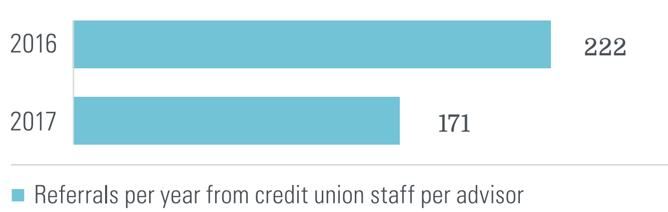
Advisor Asset Productivity

While average advisor revenue productivity was down, credit union advisors increased the amount of investment

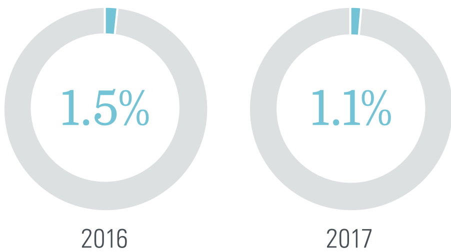
3. Member Penetration (median)



4. Branch Referrals per Advisor



5. Household Referral Penetration

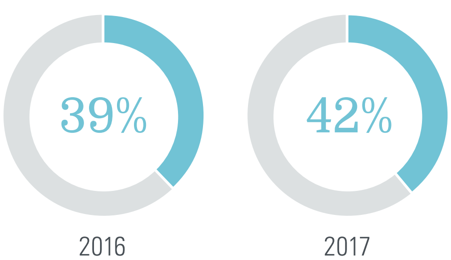


Referrals per year as a percent of credit union's member households

6. Share Revenue Penetration

Gross revenue from investment services per million of share deposits

7. Effective Advisor Payout Rate



Advisor cash compensation as a percent of gross revenue produced by advisors

8. Advisor Asset Productivity (median)

Investment assets under administration per advisor (millions)

account assets they managed by 4% to $53 million (Fig. 8). While this is notable, it pales alongside the increase in the market value of assets under administration during the year. The S&P 500 was up 19% in 2017, for example. So asset productivity should have increased significantly more.

A better measure of advisor performance is how much new assets the typical advisor brings into the credit union over the course of the year. The average advisor working in a credit union acquired $6.3 million in new assets during 2016, down only slightly from the previous year (Fig. 9). This is impressive given the influx of new advisors, who typically take a few years to get traction and would be expected to acquire less new assets than an advisor with longer tenure.

Some firms are beginning to tie advisor compensation to asset acquisition, and given the shift to advisory business, acquisition of new assets is becoming a strategic imperative. Yet many firms still do not track new asset acquisition—only the net change in assets under management.

Revenue on Assets

As the business shifts from commissions-for-transactions to fees-for-advice, the revenue earned on assets under administration is also becoming a key metric. ROA slumped in 2017 to 62 basis points as revenue grew more slowly than the value of assets under administration (Fig. 10).

Low-cost providers are putting downward pressure on the fees that firms can charge for managed money accounts, and some credit unions prepared for the impending fiduciary rule by imposing commission ceilings on some products. Consequently, advisors and their firms are earning less revenue per dollar invested.

Clients per Advisor

One factor that has historically restricted growth in credit union investment services is the bloated size of the typical advisor's book of business. With so many clients, advisors struggled to devote sufficient time to each one to uncover additional opportunities and to meet additional needs. Credit unions have made good progress on culling the books of their advisors so they can provide enhanced advice to their clients.

But during 2017, that progress appears to have taken a step back. Advisors in the credit unions in this year's survey had 478 client households at the end of 2017, up 25% from the credit unions in the previous year's survey (Fig. 11).

Other analysts tend to report the number of accounts per advisor, which misstates the actual client load, because many clients have more than one account with the advisor. The advisors in the survey averaged 1,120 accounts.

Coverage of the Opportunity

Kehrer Bielan’s long-running research has demonstrated that the number of advisors a credit union deploys relative to the size of its opportunity is the single most important determinant of investment services performance. Credit unions averaged one advisor for every $296 million in share deposits in 2017, the same as the previous year (Fig. 12).

In 2017 the rapid growth in advisor headcount kept pace with the strong growth in share deposits. This contrasts with the experience in 2016, when advisor coverage of deposits thinned out slightly from the previous year, as share deposits grew faster than the number of advisors.

Kehrer Bielan estimates that the best practices coverage ratio is in the range of $125 million–$150 million in share deposits per advisor, so the typical credit union needs to double its advisor headcount to maximize its opportunity in investment services.

Revenue Mix

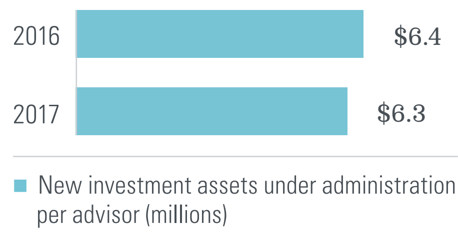
Credit unions have made great strides toward transitioning from a primarily commissions-for-transactions business to a model grounded in charging fees on assets under management. In the typical credit union, 59% of investment services revenue is now recurring, up from 50% the previous year.

The share of revenue in advisory business is a better indicator of the future health of the investment services business in credit unions, since fees on advisory business are a multiple of 12b-1 fees and trail commissions. During 2017, credit unions increased the share of their investment services revenue from advisory fees from 25% to 33%, while shrinking the share of transaction commissions from 48% to 39% (Fig. 13).

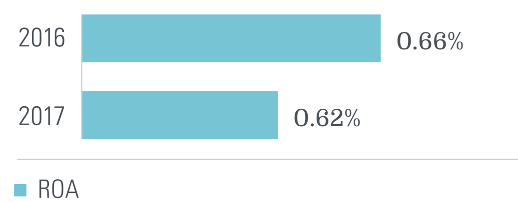
Credit unions began emphasizing advisory business years ago, drawn to the recurring revenue that managed accounts generate year after year. Then the Department of Labor’s proposed fiduciary standard rule for qualified retirement accounts spurred credit unions to accelerate the transition.

While the increase in fee-based business in credit unions is heartening, revenue derived from life insurance sales remains disappointing. Life insurance sales account for a mere 2% of investment services revenue in the typical credit union. Being a holistic provider of financial advice means also solving client protection needs. Life insurance has the potential to compensate for the revenue lost as fees compress and advisors have fewer commission transactions and earn lower commissions on the ones they do transact.

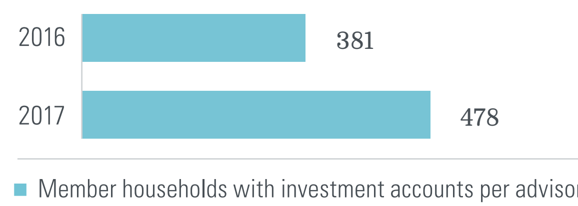
9. Advisor Asset Accumulation



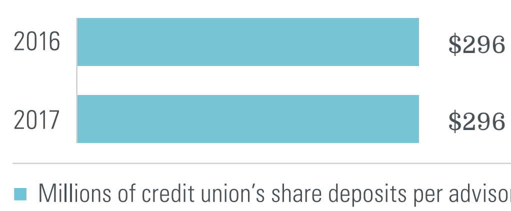
10. Investment Services Revenue as a Percent of Assets



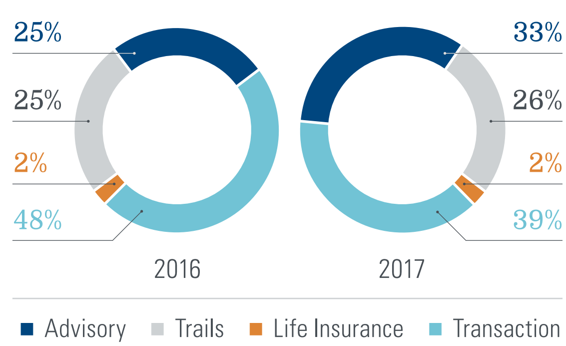
11. Clients per Advisor



12. Advisor Deposit Coverage (median)



13. Trends In Product Mix



EXECUTIVE SUMMARY

Investment services revenue in credit unions increased in 2017 despite the challenges posed by fee compression, declining transaction volume, and dwindling branch traffic.

Credit unions added financial advisors at a breakneck pace in 2017. The addition of new advisors contributed to revenue growth, but also resulted in a 12% falloff in average advisor productivity and a significant compression of profit margins because advisors new to the firm take time to ramp up their production and can be a drag on some performance measures in the short term. To capitalize on the full potential of their beefed-up sales force, credit unions should focus on and invest in keeping their new advisors through the ramp-up period and into maturity.

Already the addition of new advisors provided a boost to member penetration, which improved by 18% in 2017.

Referrals from the credit union to the investment services unit are becoming scarce as branch traffic continues to dwindle and more financial business is done online and over the phone.

Credit unions appear to be poised to capitalize on their opportunity to serve the holistic financial needs of their members—and the revenue that those services generate—as they continue to add advisors and focus on advisory business.

About the Authors

Kenneth Kehrer, PhD – Dr. Kehrer has been studying the transformation of banks and credit unions to financial services stores since the early 1980s. His research has influenced the metrics that a generation of industry practitioners use to assess their businesses and assimilate best industry practices. He also pioneered the concept of forming bank roundtable discussion groups that bring together professionals with similar job responsibilities to share experiences and react to the latest research. The work he formerly did through Kehrer-LIMRA was the foundation of Kehrer Saltzman & Associates and now Kerhrer Bielan Research & Consulting.

Tim Kehrer – Tim Kehrer directs the firm's benchmarking research, which includes surveys of bank broker dealers, third-party broker dealers, regional and community banks and credit unions, and other wealth management firms. He is co-author of a study of the opportunity for credit unions in offering investment services, the landmark study of the value of an investment client to a bank or credit union, and a study of how to create an effective compensation plan for Financial Advisors in credit unions.

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Kehrer Bielan Research & Consulting provides the financial advice industry with insights based on a melding of research and experience in managing the delivery of investment, insurance, and wealth management services. We provide performance assessment and benchmarking, human resource management and development, due diligence, consumer insights, and interpretation of industry trends through our award-winning research, objective consulting, and peer study groups.
For more information please visit www.kehrerbielan.com or email info@kehrerbielan.com.

Appendix: Participants in 2017-2018 Credit Union Investment Services Benchmarking Survey

Allegacy FCU
Alliant Credit Union
Altra FCU
American Airlines FCU
Armco Credit Union
Boeing Employee CU
CAP COM FCU
CEFCU
Centra Credit Union
Chartway FCU
Coastal Community Credit Union
CoastHills Credit Union
Community First Credit Union
CommunityAmerica
Deere Employees Credit Union
Delta Community Credit Union
Denali Federal Credit Union
Desert Schools FCU
Digital Federal Credit Union
Dupaco Community Credit Union
Eastman Credit Union
Educational Employees CU
Elements Financial FCU
Elevations Credit Union
Enrichment Federal Credit Union
Erie Federal Credit Union
ESL Federal Credit Union
Fairwinds Credit Union
Financial Partners Credit Union
First Peoples Community FCU
First Tech Federal Credit Union
Franklin Mint FCU
Gesa Credit Union
Hudson Valley FCU
Interra Credit Union
Kinecta FCU
Kirtland FCU
Lake Michigan Credit Union
Lake Trust Credit Union
Landmark Credit Union
Langley Federal Credit Union
Logix FCU
Mountain America CU
MPECU
Navy Federal Credit Union
Northwest Federal Credit Union
OneAZ Credit Union
Orange County's Credit Union
Oregon Community CU
Palmetto Citizens FCU
Partners FCU
Premier America Credit Union
Redstone FCU
Sacramento Credit Union
SAFE Credit Union
San Diego County CU
SchoolsFirst FCU
SEFCU
Sharonview FCU
Space Coast Credit Union
Suncoast Credit Union
Teachers Credit Union
TechCU
Texas Dow Employee CU
The Golden 1 Credit Union
Tower FCU
Travis Credit Union
Tropical Financial Credit Union
United Nations FCU
Unity Financial FCU
UW Credit Union
Verity Credit Union
Visions FCU
VyStar Credit Union
Wescom Credit Union
WSECU

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Not Guaranteed by Any Government Agency	Not a Bank/Credit Union Deposit	

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