

The Safety Paradox

Why the Credit Union Industry is Safe, Sound, and Slowly Shrinking

Agenda

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Part II: The State of the Industry (9/30/2025)

Part III: The Core Diagnosis – "The Fortress Trap"

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Q&A and CU HealthScore Tool Demo

Executive Summary

As of September 30, 2025, the credit union industry appears, on the surface, to be stronger than ever. **The aggregate HealthScore stands at 5.81**, placing the industry firmly in the Low Risk (Tier 1) category. Capital levels are at historic highs, and earnings have stabilized.

Part I: The Diagnostic Framework: Understanding the CU HealthScore

What is Measures

Unlike traditional regulatory exams which focus primarily on safety (CAMELS), the HealthScore measures Safety and Vitality in equal measure. It synthesizes 17 distinct performance components across six critical categories:

1. **Capital:** Net Worth & Solvency (The safety net).
2. **Asset Quality:** Delinquency, Charge-Offs, & Loss Coverage (The risk profile).
3. **Earnings:** ROA, OpEx, & Efficiency (The fuel).
4. **Liquidity:** Cash, Funding Stability, and Asset Deployment (The flexibility).
5. **Growth:** Loans, Assets, & Membership (The momentum).
6. **Engagement:** Depth of wallet share per member, & borrower engagement (The relevance).

The Scoring Scale: The "Historical Average" Benchmark

Every component and the final aggregate HealthScore is plotted on a 1 to 10 scale. Crucially, this scale is anchored in 20 years of historical industry performance:

- **The "5.0" Anchor:** A score of 5.0 represents the historical industry average. For example, if the 20-year average ROA for credit unions is 0.50%, an institution achieving exactly 0.50% ROA receives a score of 5.0.
- **Interpretation:** Therefore, a credit union with a HealthScore of 5.0 is performing exactly in line with the long-term community norm.
 - > 5.0: Performing above the historical average.
 - < 5.0: Performing below the historical average.
- **Predictive Validity:** The score is mathematically calibrated to risk. Historically, a 1-point drop in the HealthScore corresponds to an approximate 65% increase in the probability of failure.

The Risk Tiers

We categorize institutions into three distinct risk profiles based on their score and their capital position:

- **Tier 1: Low Risk (HealthScore \geq 5.0)**
 - Definition: Financially sound and resilient. These institutions are performing at or above the historical industry average.
- **Tier 2: Medium Risk (HealthScore 4.0 – 4.99)**
 - Definition: Stable but vulnerable. These institutions have slipped below the historical average and require closer monitoring of specific weaknesses.
- **Tier 3: High Risk (HealthScore $<$ 4.0 OR Net Worth Score $<$ 5.0)**
 - Definition: Immediate distress.
 - The Critical Override: Even if an institution has a passing HealthScore (e.g., 6.0), if their Net Worth Score falls below 5.0 (below average capital), they are automatically flagged as High Risk. Safety is non-negotiable.

Part II: The State of the Industry (9/30/2025)

The State of the Industry

Viewed through the HealthScore lens, the Q3 2025 data presents a clear picture of a mature, conservative system.

- **Aggregate HealthScore:** 5.81 (Tier 1 / Low Risk)
- **Dominant Strength:** Net Worth (Score 8.98). The industry is effectively "over-insured" against failure.
- **Critical Weakness:** Membership Growth (Score 2.30). This is the lowest scoring component in the entire model.

The Risk Tier Landscape

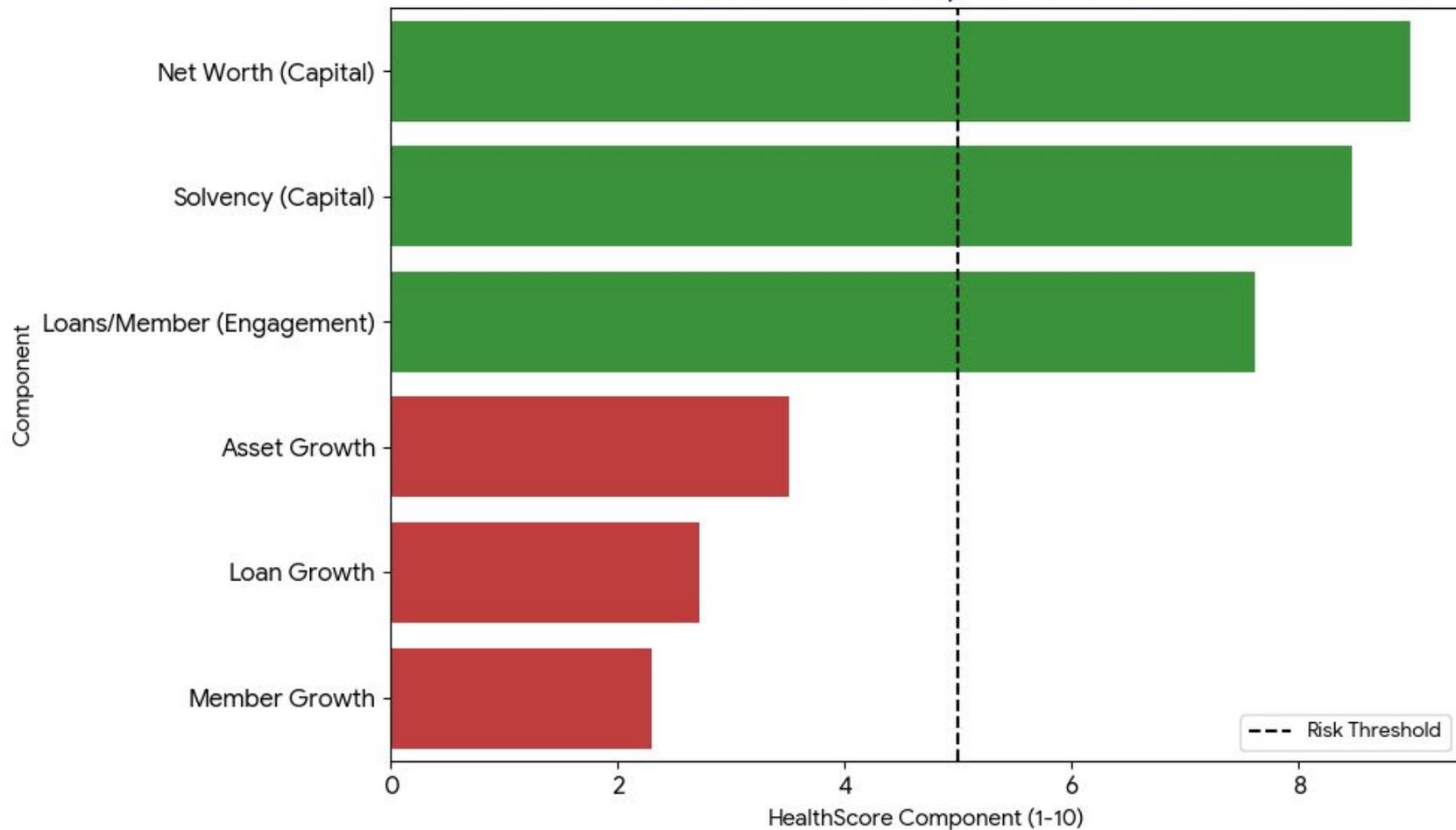
The industry has largely migrated out of the "Danger Zone."

- **Tier 1 (Low Risk):** 78.0%. Nearly 8 out of 10 credit unions are performing above the historical average.
- **Tier 2 (Medium Risk):** 16.4%. These institutions are stable but inefficient.
- **Tier 3 (High Risk):** 5.6%. A small minority facing immediate capital or performance crises.

The takeaway:

The risk of mass credit union failure is near zero. The risk of mass credit union irrelevance is rising.

The "Bifurcation": Safety vs. Growth Scores



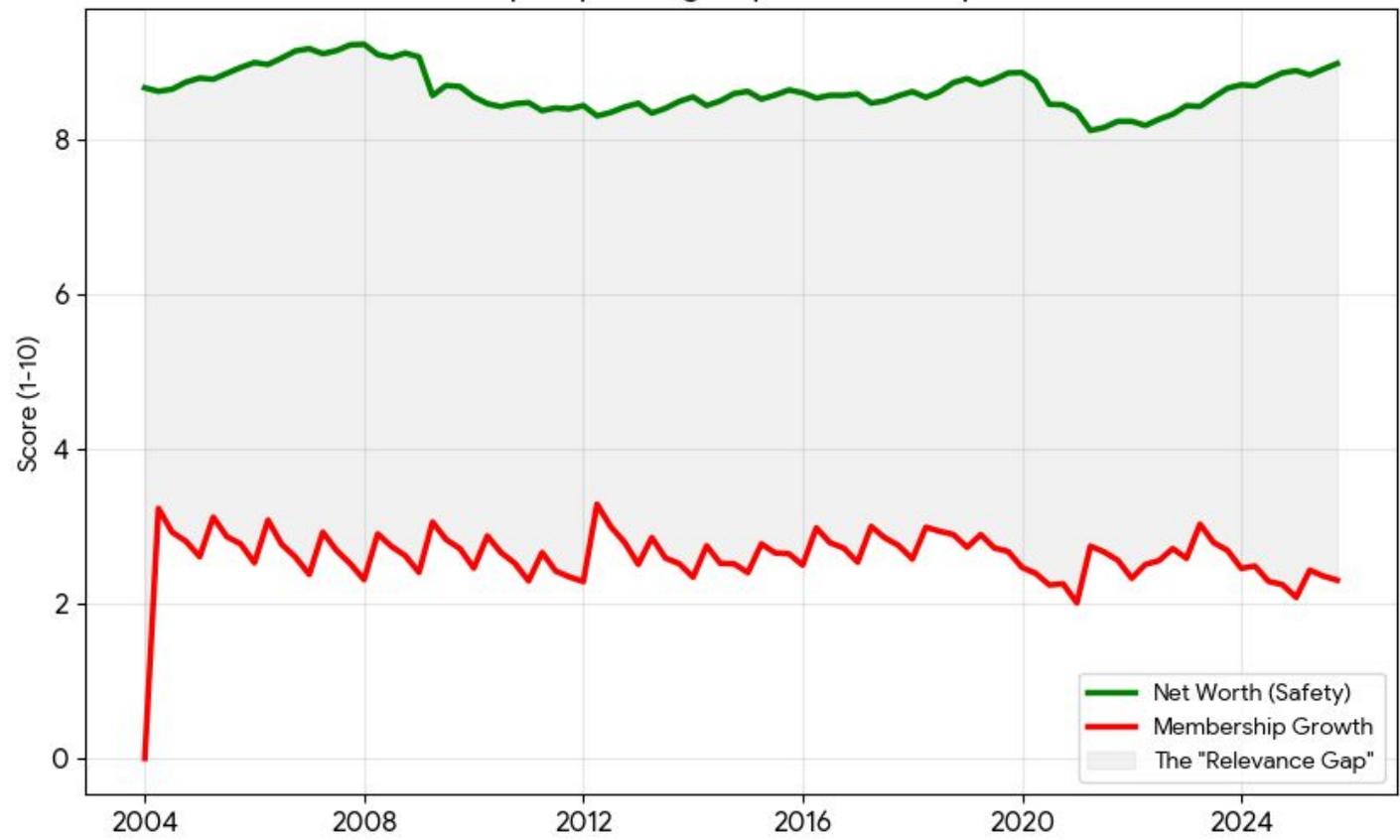
Part III: The Core Diagnosis — "The Fortress Trap"

"The Fortress Trap"

As Net Worth scores climbed year over year (reaching near-perfect levels in 2025), Growth scores have inversely crashed. Institutions have prioritized building fortress-like balance sheets at the expense of market expansion.

- **The Symptom:** High ROA and High Capital, but zero or negative member growth.
- **The Reality:** These institutions are effectively liquidating the business in slow motion. They are extracting value from an aging membership base without replacing the pipeline.
- **The Forecast:** If this trend continues, our models predict the aggregate HealthScore will drift downward to 5.71 by late 2026. Capital will continue to pile up (projected Net Worth Score > 9.1), while Loan Growth continues to fall.

The Fortress Trap: Expanding Gap Between Capital and Growth



Part IV: The Four Faces of the Industry

The Four Faces of the Industry

The "Average Credit Union" is a myth. Our granular analysis of the 4,419 distinct institutions reveals four specific profiles that define the current landscape.

1. The Drifters (The Silent Majority)

Prevalence: ~32% of the Industry

Profile: Tier 1 (Score 5.0 – 5.9).

The Diagnosis: These institutions are "Comfortably Average." With scores hovering just above the 5.0 historical benchmark, they are technically healthy, but they excel at nothing. They have high capital (8.9) but mediocre efficiency and low growth. They are cruising on inertia.

The Risk: Complacency. Being "average" in a consolidating market is a slow path to irrelevance.

2. The Fortress Trap (The Rich & Stagnant)

Prevalence: ~30% of the Industry

Profile: Tier 1, High Score (>6.0), but Growth Scores in the Red (<3.0).

The Diagnosis: These are the financial powerhouses. They have massive retained earnings and elite ROA, but they are shrinking. They have the resources to dominate their markets but are choosing to save for a rainy day that never comes.

The Risk: Obsolescence. They are the "rich" institutions that will eventually run out of members.

3. The Balanced Builders (The Gold Standard)

Prevalence: ~15% of the Industry

Profile: Tier 1, High Score (>6.0), High Growth (>3.0).

The Diagnosis: The elite. These institutions prove the trade-off between safety and growth is false. They use their capital to fund expansion, maintaining high scores across the board.

The Strategy: These are the acquirers of tomorrow.

4. The Sleepers & Strugglers (The Vulnerable)

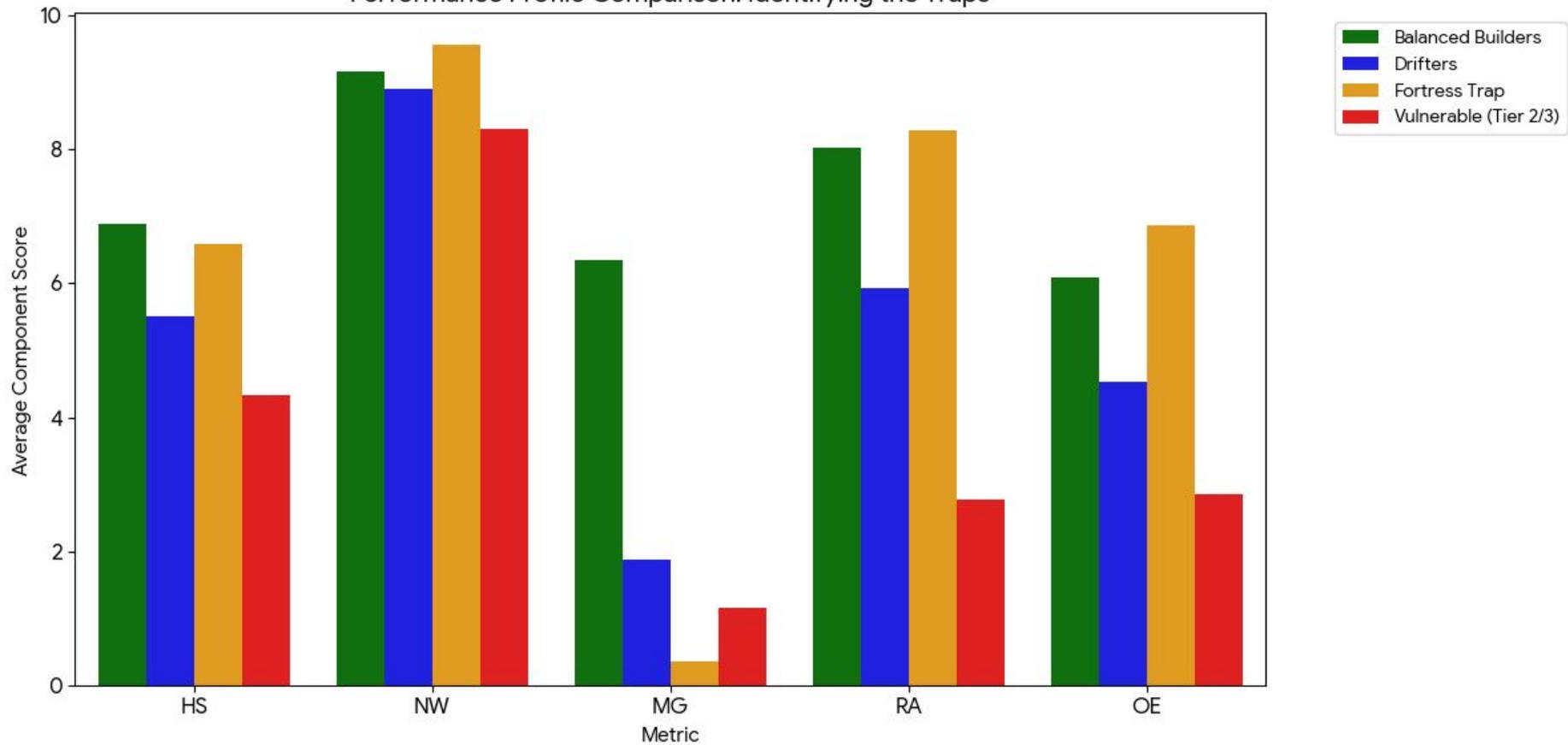
Prevalence: ~23% of the Industry (Tier 2 & 3).

Profile: Scores < 5.0.

The Diagnosis:

- **The Sleepers (Tier 2):** Held back by Efficiency. They are bloated.
- **The Critical List (Tier 3):** Often triggered by the Net Worth Safety Override (<5.0). These institutions are one recession away from a forced merger.

Performance Profile Comparison: Identifying the Traps



Part V: The Strategic Mandate for 2026

For "Fortress" and "Drifters" (Tier 1):

Mandate: Weaponize Your Net Worth. You are sitting on a war chest of capital. Holding a Net Worth ratio significantly above regulatory requirements in a low-growth environment is a strategic error.

- **Action:** Intentionally lower your Net Worth score to raise your Growth score.
- **How:** Invest in technology, aggressive marketing, or M&A. Buy market share. Buy younger members. You can afford the "J-Curve" dip in earnings; you cannot afford the flatline in membership.

For The "Sleepers" (Tier 2):

Mandate: Fund Focus via Efficiency. You do not have the capital surplus to buy your way out. You must cut your way to growth.

- **Action:** Relentless focus on OpEx.
- **How:** Every dollar saved in back-office inefficiency must be redeployed to member-facing value (rates or tech).

For The "Strugglers" (Tier 3):

Mandate: Seek Shelter. If your Net Worth score is below 5.0, you are in the statistical "Kill Zone."

- **Action:** Immediate preservation or partnership.
- **How:** Stop asset growth (to preserve ratios) and actively seek a Tier 1 merger partner while you still have member value to negotiate.

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