FEBRUARY 2004

NEWS

AN ELECTRONIC REPORT FROM THE CUNA CHIEF FINANCIAL OFFICER COUNCIL

MESSAGE FROM THE CHAIR

Scott Waite

Happy New Year! I am happy to report that your Executive Committee has been very busy during the last year. Let me take a moment to bring you up to date. The Conference Committee has put the finishing touches on a wonderful agenda for our 10th Annual Conference in May. "That was *then*, This is *now*, This is *how*" is our theme. We have many topics of educational value and a tremendous lineup of speakers. Our "Partners in Finance" sponsors have already contributed over $100,000 and we appreciate their continued support and involvement. We also plan to recognize our long-standing Council members again. We have commissioned a very elegant service award to be presented to our members who have been with the CFO Council for all of its 10 years. Yes, there are over 40 of them still around. A new group has also reached the 5-year plateau and will also be recognized. Our social event will be an evening at the world famous San Diego Zoo in Balboa Park. I'm sure that you won't want to miss the opportunity to attend the Annual Conference in San Diego, California. You can review the agenda and register online at our website.

Our Membership and Benefits Committees have also been in full swing, recruiting and retaining members and enhancing your benefits of membership. Our membership reached an all time high of 512 members and new members are joining each month. The Communications Committee has focused on several areas as well. Our website and listserv are more active than ever before. They continue to provide round-the-clock information and networking opportunities. White Papers were also published and posted on our web site. And our Regulatory Comment Committee continues to facilitate comment calls and works regularly with CUNA's D.C. office on regulatory and accounting changes. Our Council committees are made up of members who have dedicated their time and energy towards these and many more initiatives. I would like to extend my thanks to all of them for another productive year.

Executive Committee Update

We have also just started the process for the annual election for Executive Committee members. Interested candidates will be running for three seats on the committee. Alan Wade has been selected to chair the Nomination Committee this year. He is completing his fourth and final year on the Executive Committee and knows what it takes to present a fine slate of individuals who are willing to promote the CFO Council movement. Two former Executive Committee members, Linda Darling and Judith Hillock, will assist him. I encourage you to please take the time to register your vote.

The Organization of Choice for CFO's:

It's been another exciting and productive year for the CUNA CFO Council. I personally believe that our mission is to strive to be the professional organization of choice for credit union CFOs. To do so, we need to continually provide better value for your membership. Of course, I think that we do a very good job already, but our committees of talented financial professionals have much more in store for you. Each of them continues to contribute their vision, energy, and time towards this mission. I'm proud to say that they have consistently come through. It's a true pleasure working with them.

Lastly, I appreciate the opportunity to continue to serve you as Chair. If there is anything that I can personally do to enrich your experience with the CUNA CFO Council, please let me know. ◆

Scott M. Waite, Sr. VP-CFO
Patelco Credit Union

In This Issue

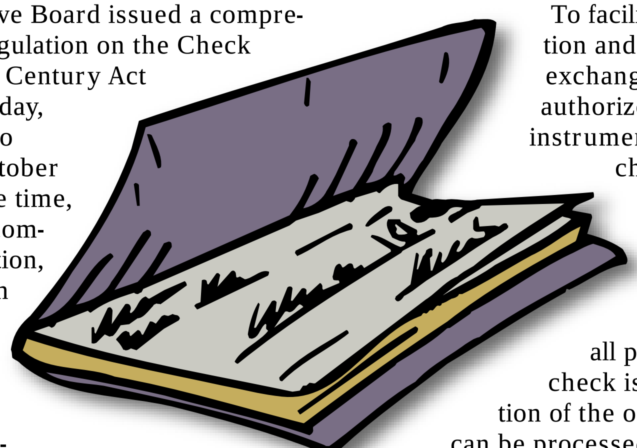
Join the credit union movement's top CFOs in an exciting environment that is conductive to learning with, and from, your peers. Come to San Diego for an eye-opening agenda that will leave you relaxed yet energized. You are sure to find new ways to learn from the past and plan for the future.

Register today!

For more information, go to *http://www.cunacfocouncil.org/conference_04.html*

EYE ON WASHINGTON

Federal Reserve Issues Check 21 Proposed Regs CUNA Calls on Credit Unions to Comment



The Federal Reserve Board issued a comprehensive proposed regulation on the Check Clearing for the 21st Century Act (Check 21 Act) Monday, December 22, 2003 to become effective October 28, 2004. At the same time, The Fed requested comments on the regulation, to be made by March 12, 2004.

CUNA's Payment Systems Subcommittee will be reviewing the proposed regulation. CUNA intends to take advantage of the Fed's invitation to comment and calls on small credit unions, in particular, to comment.

"The Federal Reserve should be commended for its early release of model disclosure language, which will help credit unions prepare for the new consumer education requirements to their members," said CUNA Assistant General Counsel Michelle Profit.

To facilitate check truncation and electronic check exchange, the Check 21 Act authorizes a new negotiable instrument called a "substitute check" and provides that a properly prepared substitute check is the legal equivalent of the original check for all purposes. A substitute check is a paper reproduction of the original check that can be processed just like the original check. The Check 21 Act does not require any bank to create substitute checks or to accept checks electronically.

The proposal would:

- Set forth the requirements of the Check 21 Act that apply to banks;
- Provide a model disclosure and model notices relating to substitute checks; and
- Set forth bank endorsement and identification requirements for substitute checks.

The proposal also clarifies some existing provisions of the rule and commentary.

Certain provisions of the law will affect all financial institutions; even those that do not choose to create substitute checks. Among other things, any financial institution:

- Simply receiving a substitute check created by another institution, or a paper or electronic representation of a substitute check, would make the substitute check warranties while it delivered that item for presentation, collection, or return or provided that item to its consumers;
- Receiving consideration for a substitute check or a representation of a substitute check that it transfers, presents, or returns also is responsible for indemnifying any person that suffers a loss due to the receipt of a substitute check instead of the original check.
- Would have to issue check-21 disclosures to any member/customer who receives a substitute check.

Thus, the regulations outline the requirements of Check 21 that apply to financial institutions, model disclosures and model notices regarding substitute checks, endorsement and identification requirements on substitute checks for the financial institutions that truncate and convert electronic checks into substitute checks, and changes to existing provisions of the Regulation CC and its commentary.

Credit unions will be affected by these regulations because they mandate new disclosures and create potential liability for them when their members handle "substitute checks." Although most credit unions truncate and those that do will have limited contact with substitute checks, all credit union members use substitute checks in certain ways that trigger the new disclosures and liability rules.

Specifically, for those credit unions that do not return share drafts to their members, the disclosure rules and special expedited recredit rules will apply to a member who deposits the check of a third party, if that check bounces and is returned in the form of a substitute check to the member. These provisions will also cover members who request a copy of their share draft and receive a substitute check.

The new check truncation law does not mandate that all financial institutions be willing to accept electronic checks, but all institutions must accept a "substitute check," which is the paper copy of the electronic check file.

CUNA is asking credit unions to submit comments on the proposed regulations. More information about the statute and questions for credit unions to consider in developing their comments is contained in CUNA's comment call at www.cuna.org/reg_advocacy/member/download/rcc_010804.pdf. Further information on how to comment to CUNA – by February 24 – or directly to the Fed – by March 12 – is also in the comment call. ◆

The Federal Reserve Board's proposed regulation is at *www.federalreserve.gov/BoardDocs/Press/bcreg/2003/20031222/attachment.pdf*

And the Fed's request for comment at *www.federalreserve.gov/BoardDocs/Press/bcreg/2003/20031222/default.htm*

The CUNA summary and analysis is at *www.cuna.org/reg_advocacy/member/analysis/fed_110403.html*

The latest information is available in CUNA's e-guide at *www.cuna.org/compliance/member/eguide/eguide_regcc_status.html*

Treasury Looking at Credit Union Risk-Based Capital

Assistant Treasury Secretary for Financial Institutions Wayne Abernathy says he is looking at possible changes to credit union capital standards and whether they should become risk-based. Abernathy made the remarks at the Consumer Federation of America's Financial Services Conference in Washington, D.C.

Abernathy noted that credit unions apply the same capital standards to all assets regardless of their riskiness. He asked whether less capital should be put up against more secure loans. "My guess is this would free up this capital and allow credit unions to grow," he said. "We're looking at and considering this and we want your feedback," he told conference attendees.

CUNA staff has been meeting with Abernathy over the course of the last few months to encourage support for improvements along the lines of what he discussed, particularly relating to Prompt Corrective Action. The recently introduced Credit Union Regulatory Improvement Act (CURIA) contains a provision that improves net worth requirements.

"We discussed this provision after it was introduced as part of CURIA," said Gary Kohn, CUNA's vice president of legislative affairs and senior legislative counsel. "We are very pleased that the results of our meetings have led to serious consideration of the issue at Treasury."(News Now January 16, 2004) ◆

CUNA white papers that explore reforming PCA and secondary capital can be found at *www.cuna.org/econ/member/white_papers.html* and *www.cuna.org/gov_affairs/legislative/issues/curia.html.*

PRODUCTS & SERVICES

A Tool for CUs to Offer the Self-Employed

Credit unions interested in expanding service to small business owners may want to check out a little-known provision in the 2001 tax-law changes: the Solo 401(k) or single-owner 401(k), which allows the self-employed and their spouse to put away more money than almost any other retirement plan available to them.

The Solo 401(k) lets a person defer up to $12,000 of pretax income and make a tax-deductible contribution up to 25% of his or her total income, for a combined $40,000 (plus allowing a potential extra $2,000 in catch-up for someone age 50 or older). Another benefit: Members can borrow half the amount saved (up to $50,000) and repay themselves during a period of up to five years.

Credit unions interested in offering this service to members with small businesses would need to work with a pension provider, putting the member together with that provider.

Credit unions should look at their business-services portfolio and strategic goals before approaching a vendor to determine if they want to make a commitment to offering pension/retirement account services as part of their overall business services products. Credit unions occupy a very opportunistic niche to market pension/retirement account services to small business owners because of the unique relationship many have with member business owners, and a Solo 401(k) is the kind of product many credit union members would probably find attractive. ◆

Excerpted from The Point for Credit Union Research and Advice

MBLs Increase & Diversify Lending Portfolios

Member business loans (MBLs) are a dependable vehicle to increase and diversify credit union lending portfolios, according to Jean Faenza, EVP Telesis Community Credit Union, Chatsworth, CA. Six years ago, Telesis had a 50% loan-to-share ratio; today it's 94%.

Telesis started its MBL program in 1992 after many members became entrepreneurs. At the beginning, training was a cultural shock. "We had to go out and hire staff with expertise. The NCUA requires two years of experience, I say you need two plus two plus two," said Faenza.

Since its inception, the Telesis MBL program has had no delinquencies or foreclosures. Telesis offers a full range of business services including business online banking, 24-hour account access, free bill payer, and a CheckDirect Visa check card. "Members are looking for a partner for the future," says Faenza. "They want advice. You don't have to offer every service, but you need to offer referrals for the services you don't have."

MBLs can bring a host of benefits such as meeting member needs as well as developing a primary financial institution relationship with existing members. MBLs can also attract new members and expand the credit union's community image.

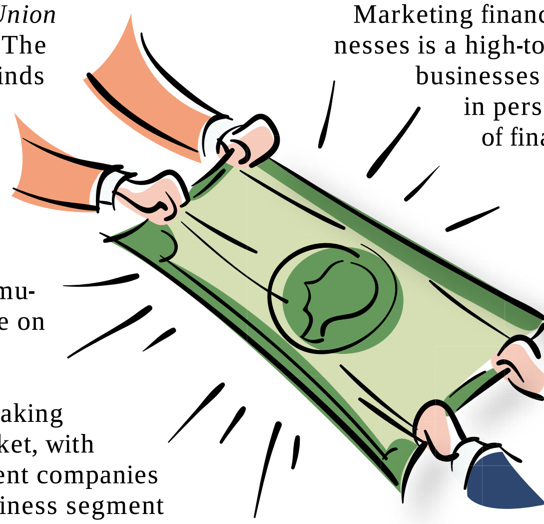
Some 15,000-20,000 small businesses switch financial institutions each year because of lack of personal service or key contact person, and the financial institution makes no effort to retain their business, said Faenza. Since credit unions are recognized for their quality service, they have an opportunity to attract these dissatisfied businesses.

Telesis offers business money management accounts with competitive/tiered interest rates with no service fees with a minimum balance. A minimum $10,000 balance is needed to earn dividends. Faenza recommends that credit unions pay close attention to pricing by surveying the competition, especially commercial banks. ◆

Courtesy of *Credit Union Business Services Solutions*

Competing for Small Business Financial Services Market Share

Competition for small business financial services will continue to increase in intensity for the foreseeable future, according to a TowerGroup report available through CUNA's *The Point for Credit Union Research and Advice*. The TowerGroup report finds that small business entrepreneurs are spreading their business around more than ever. Technology has allowed smaller community banks to compete on a more equal footing with larger banks. Nonbanks are also making inroads into this market, with 45% of SOHO *segment companies and 65% of Small Business segment companies using a non-bank for financial services.



Credit and deposits are the cornerstones of small business financial relationships and are the product areas most under fire. Banks, in particular primary provider banks, dominate these product areas as well as the cash management area. Nonbanks such as brokerage firms, mutual fund companies, and insurance companies are major competitors in the highly profitable areas of retirement services and commercial investments.

Marketing financial services to small businesses is a high-touch proposition. Most small businesses prefer to conduct research in person concerning possible use of financial services; telephone is their second choice. Use of the PC and Internet for product research is fairly low.

Segmenting, both demographic and "firmagraphic," is the key to more targeted and effective marketing to the small business market. Larger companies have more potential and warrant greater attention. Segmenting by industry, years in business, and number of full-time employees can help direct marketing efforts for specific services to those companies most likely to need them. ◆

* *Small office, home office*

New Program to Tap Talents of CU Innovators

The Filene Research Institute has formed a new association dedicated to stimulating innovation and leadership development of next generation leaders in credit unions. Filene is soliciting candidates to fill out a 25 member roster to form I^3, a group of aspiring credit union leaders from across the nation. The name I^3 refers to Credit Union Ideas, Innovations and Implementation.

I^3 will develop ideas and initiatives that address major issues facing credit unions; identify developments in other financial institutions that can be adopted by credit unions; and provide a forum for cooperation, collaboration, professional development and industry succession planning. The development of I^3 has been made possible in part by a grant from US Central Credit Union.

The initial recruiting goal is to identify innovative, insightful and energetic credit union professionals who have not yet reached CEO level. These will be highly regarded managers reflecting the gender, racial, national origin and geographic diversity of U.S. credit union membership.

Members of I3 will serve staggered three year terms. The initial group of successful candidates will begin serving in 2004, with a second group joining the program in 2005. ◆

For more information on I3 or to submit an application, contact Mark Meyer at (608) 231-8554; or visit the Filene Web site at www.filene.org for full application details.

HEARD IT ON THE LISTSERV

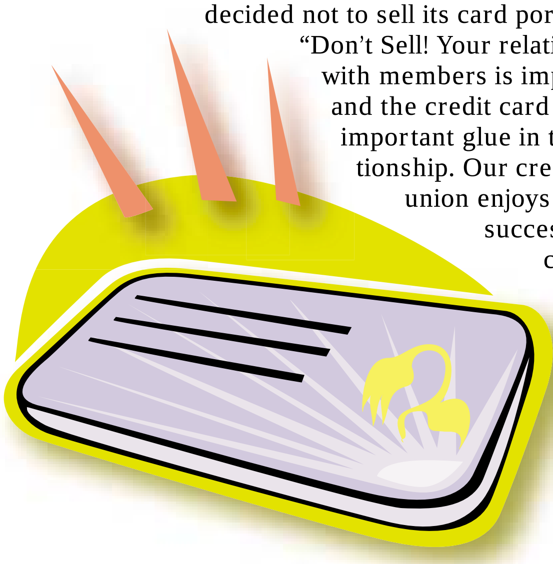
The CFO Council listserv is an excellent resource through which to obtain advice and council on pending issues, and to network with fellow members. Here's a digest of some subjects recently discussed by members. Check it out for yourself, for a more complete review of comments and suggestions.

Credit card portfolios

A Council member reports that in view of increased pressure on margins, the credit union is considering selling its credit card portfolio. The member seeks advice both from those who have sold their card portfolios, and those who considered the move and decided not to sell.

A member whose credit union sold a $5M card portfolio reports working with a consultant who offered "an excellent presentation package along with all the numbers that you can use to go over with your board when the time is right." The consultant worked with several buyers and helped through the negotiations. The credit union has been very pleased with its move.

And this from a credit union that decided not to sell its card portfolio: "Don't Sell! Your relationship with members is important, and the credit card is an important glue in that relationship. Our credit union enjoys a most successful card program because we recognize the importance of this product. We market it and set fair rates for members. There are lots of great ways to market credit cards in the credit union way. I think you need a driver for this program, a senior staff person preferably that will drive the marketing, processing, and pricing, and ensure that all necessary steps are being taken to make the program a success."



A number of other respondents also urged the credit union to retain its card portfolio.

Board meeting fees

A Council member reports that the credit union is "considering raising the amount we pay to board members for meetings, I was wondering what other state chartered credit unions are paying."

A substantial majority of respondents report that they do not pay directors. However, some pay a meal fee, some provide reimbursement for auto mileage, some pay "credit union related expenses incurred by board members in attending meetings." One respondent asks: "Are we supposed to pay them?"

Another member reports: We reimburse directors at the maximum meals and incidentals per diem allowed by the IRS. The allowable per diem rate varies by location and by time of year. IRS Pub 1542 has all the per diem charts."

But this from another respondent: "We pay board members $200 per meeting, including board sub-committee meetings. Our credit union has paid board members an honorarium for decades. The current belief is that the board members are an integral part of our credit union and we need high quality, knowledgeable directors. The feeling is that the $200 we pay them per meeting is well spent for the value that they contribute to the credit union."

Unsecured loan limits

A credit union in the process of re-evaluating its unsecured loan limits asks what limits others set for unsecured loans, and how that amount is decided. (Are loan limits in line with the 20-30% of household income and are they based on aggregate unsecured loans outstanding?)

A few responses: "Our unsecured limit is 30% of household income. Tier 1 maximum unsecured is three times monthly income; tier 2 is two times monthly income; and tier 3 is one time monthly income. This typically limits unsecured debt to less than 30%. There are cases where we approve outside these guidelines."

"Our signature limit is two times the member's gross monthly income. This signature limit encompasses the aggregate balance of credit cards, lines of credit, and unsecured loans."

Service Fees

In response to a question regarding service charge fees for letters of credit; garnishments; levies such as child support and sales tax; and dormant accounts, Council members report a range of practices. For letters of credit, the preponderance of opinion is to offer this service without charge. Most responding credit unions also charge no fee for garnishments and other levies, but a $20-$25 fee is reported by a few credit unions. The category in which many credit unions do charge a modest fee is dormant accounts: typical is a charge of $3-$6 per month after one or two years dormancy; however, some of these credit unions make exceptions for high balance account, IRAs, and young members.

Consulting expense

A Council member asks if the expense of hiring a consultant to coordinate a data processing conversion can be capitalized as part of the total project.

One respondent suggests capitalizing consultant and training costs, on the assumption that without the consultant, successful implementation would not be possible. All the costs necessary to bring the asset into productive use can and should be capitalized.

Another member reports that the credit union's CPA firm has advised that training related expenses cannot be capitalized, but other out-of-pocket conversion expenses such as data conversion over the anticipated life of the system can be capitalized.

A third member suggests checking with the credit union's external auditors, because "they are the ones who will be signing-off on your financials." ◆

CURRENT AFFAIRS

Colloquium probes a capital question

An expert on cooperative structure and capital instruments urged credit unions to learn from the experience of others at a colloquium on alternative sources of capital sponsored by the Filene Research Institute at the University of Virginia in October. Professor Michael Cook of the University of Missouri offered a perspective on how other cooperative enterprises have approached the capital question. Traditionally, Cook said, credit unions and other cooperatives have focused on protecting the assets of their owner/members. As cooperatives mature, however, they often need capital to enable future growth. Cook is currently working on a detailed report on capital issues in the cooperative sector, scheduled for publication by Filene in 2004.

CUNA Senior Vice President Bill Hampel approached the question of capital accumulation from the perspective of law and regulation, examining how changes in Prompt Corrective Action (PCA) might alleviate pressures on credit union capital ratios. High capital requirements coded in statute pose considerable difficulties for credit unions, Hampel said, and impose restrictions well beyond those placed on banks. The result is an unnecessary restraint of growth on healthy, well-managed credit unions. The solution, said Hampel, involves 1) giving credit unions access to secondary capital, and 2) reforming the rules attendant to PCA. However, significant changes on either front will require additional legislation.

Participants also heard presentations on specific ways in which credit unions might generate capital. Professor Jinkook Lee of The Ohio State University presented research findings on the inclination that members might have to accept uninsured deposit products. Lee's research demonstrates that given the appropriate information regarding return levels and safety and soundness issues, a significant segment of members would be inclined to place a portion of their funds in uninsured accounts.

James Wilcox, University of California-Berkeley professor and former Chief Economist for the U.S. Comptroller of the Currency, presented the architecture for using subordinated debt as capital for credit unions. He demonstrated how subordinated debt might benefit both credit unions and the NCUSIF by transferring risk from the fund to investors. He also advocated replacing net worth requirements under the CUMAA with capital requirements.

CUNA Mutual Senior Vice President Tom Merfeld discussed a new product designed to give credit unions access to capital. The product is being tested with low-income credit unions, which are allowed to issue subordinated debt for purposes of raising alternative capital.

"The objective of this colloquium was to gather available data on how credit unions might access the capital they need to grow and serve their members better," said Bob Hoel, Filene Research Institute Executive Director. "We saw a number of approaches that show promise in providing credit unions with the capital tools they need to grow and compete in an economic environment that is becoming more and more dependent on the effective use of capital tools. Our purpose was to present a number of alternatives through which credit unions can address this important issue." ◆

For more information on the Colloquium or the Filene Institute, go to www.filene.org

As Spreads Shrink, CUs Explore Other Ways to Generate Revenue

With competition for loans and deposits narrowing spreads and the rising cost of serving larger fields of membership, credit unions are living on less. Consequently, many credit unions are relying more on fee and other income to bolster their bottom lines.

The net yield on loans for credit unions with more than $50 million in assets was 7.03% for the first quarter of 2003, down from 7.69% for the first quarter of 2002, according to CUNA's economics and statistics department. Gross spreads declined from 353bp to 335bp during that same period. The yield on surplus funds also declined from 3.62% to 2.69%.

In 2001, net interest income averaged $3.58 for every $100 of assets – the lowest in credit union history. By contrast, credit unions earned well over $5 for every $100 of assets in the 1960s and 1970s. Net interest income might decline even further as interest rates move up, putting more pressure on credit unions to rely on non-interest income.

Credit unions are also experiencing cost increases for serving their expanding and diverse fields of membership. Those expenses have increased 85% from year-end 1990 to $215 annually per member. The growth in expenses correlates to our members' growing product and service demands, and the growth in the channels needed to deliver them.

One commonly recognized revenue-generator is the non-sufficient funds (NSF) fee on checking accounts. But there are other checking-related fees that can generate income while still providing a good service and value to members. Examples are fees on e-checks, debit cards, non-member check cashing, ATMs, and payroll cards in some areas.

Credit cards, student loans, auto loans and loan protection create other opportunities to generate revenue. But credit unions need to look at their entire loan portfolio to make sure all loans are performing well. In order to remain financially viable, credit unions must weigh all revenue options available to them, and then decide which ones fit best for their members and the credit union. ◆

Excerpted from *The Point for Credit Union Research and Advice*

GAC 2004

Fifty stars. One future.

Snow Scheduled for 2004 CUNA GAC

U.S. Treasury Secretary John W. Snow will address the opening general session of CUNA's 2004 Governmental Affairs Conference (GAC) on Monday, Feb. 23.

Snow joins other key policymakers on the program, including Federal Reserve Board Chairman Alan Greenspan, who will give his first speech to a major credit union conference.

This will be Snow's second GAC appearance. His speech at last year's conference was one of his first after taking office. Snow is the former chairman and CEO of CSX Corporation. While at CSX, he also served as chairman of the Business Roundtable, a leading business policy group comprised of 250 CEOs of the nation's largest companies. He is a former administrator of the National Highway Traffic Safety Administration and served as co-chairman of the National Commission on Financial Institution Reform, Recovery and Enforcement that made recommendations following the savings and loan crisis of the 1980s.

House Financial Services Committee Chairman Mike Oxley (R-OH) will speak Tuesday afternoon during the 2004 CUNA Governmental Affairs Conference happening Feb. 22-25 in Washington, D.C.

CUNA's 2004 Governmental Affairs Conference takes place Feb. 22–25 at the Hilton Washington Hotel in Washington, D.C. Also appearing will be Sen. Richard Shelby (R-AL), Chairman of the Senate Banking Committee and Chris Matthews, host of MSNBC's *Hardball* and NBC's *The Chris Matthews Show*. ◆

NEW MEMBERS

The CUNA CFO Council has added eleven new members to the council roster. These experts have demonstrated their commitment to promoting professionalism among credit union financial officers and to developing superior skills. In addition, they join others in networking for the free exchange of ideas and improving the overall effectiveness of their credit union's financial operations.

We welcome:

Stephen L. Daggs
Controller
First Rochester Community CU
Rochester, NY

Peter J. Desmond
Accounting Specialist
New York State CU League
Loudonville, NY

Anthony L. Emerson
VP–Finance/Acct/Operations
Maine Savings FCU
Hampden, ME

Ronald A. Flaherty
CFO
TEG Federal CU
Poughkeepsie, NY

Phyllis J. Love
CFO
Hoodview FCU
Killeen, TX

Ryan T. McIlhaney
CFO
Bay Federal CU
Capitola, CA

Rhea Nygard
Controller
Community First Guam FCU
Hagatna, GU

Seferino Oritz
SVP – Finance
ZIA CU
Los Alamos, NM

Jason A. Peach
VP – Finance
Georgia FCU
Atlanta, GA

Amy Shufelt
VP/CFO
DOT FCU
Poughkeepsie, NY

Mary K. Wehner
Accounting Manager
Aviation Associates CU
Wichita, KS

CUNA CFO COUNCIL NEWS

CFO News is a web-based newsletter published bimonthly by the CUNA CFO Council. Send news and CFO Council information to Scott Waite, SVP/CFO, Patelco CU, San Francisco, CA, phone (415) 442-7158; fax (415) 442-7193 or Mike Lord, SVP/Comptroller, State Employees CU, Raleigh, NC, phone (919) 839-5084; fax (919) 839-5100.
For council membership and administration information, call Cheryl Sorenson, manager of CUNA Council Administration, at 1-800-356-9655, extension 4393 or e-mail her at csorenson@cuna.coop.

CUNA Credit Union National Association