OCTOBER 2003

CUNA CFO COUNCIL

NEWS

AN ELECTRONIC REPORT FROM THE CUNA CHIEF FINANCIAL OFFICER COUNCIL

MESSAGE FROM THE CHAIR

Scott Waite

Executive committee members are busy chairing their respective subcommittees, with each committee working on an agenda in its field of concern. Currently, the conference committee is choosing topics and speakers for the Tenth Annual CFO Council Conference and Roundtable, May 16-19, 2004 at the Hilton San Diego Resort. The committee is relying heavily on the comment cards submitted after this year's conference to bring together appropriate content and speakers for next year's event.

I am pleased to report that your executive committee recently decided to keep CFO Council membership dues at their present level for the foreseeable future. We are able to hold the line on dues because our membership base is growing, and we are therefore able to take advantage of economies of scale.

Your executive committee is also charged with monitoring the structure of the Council to make it meaningful to all members. Of the six CUNA Councils, only the CFO Council has a very focused membership qualification, limiting membership to primary financial officers of a credit union. This target focus allows us to develop programs, events, and networking opportunities that are of specific concern and use to chief financial officers. The value of this focused approach to membership is borne out by our having recent reached a milestone, the 500 member level. We are the second largest CUNA Council.

I would also like to comment on a few major issues facing our profession today and being addressed by the Financial Accounting Standards Advisory Board and its advisory council (FASAC), on which I serve. First, business combinations for mutuals deal with the accounting treatment given to two merged entities. This rule will impact the financials of every industry in the country, and will affect the financials of the merged organizations.

Second, CUNA recently responded to the AICPA change for allowance for loan losses. Council members were asked to comment on this change, to be incorporated in the credit union response.

And third, financial institutions will be affected by changes to purchased loan accounting. The latest version of the proposal by AICPA exempts the vast majority of loans that lenders purchase.

As financial professionals, we are faced with a broad array of timely issues demanding our attention. I would ask you to remember the benefits of membership in the CUNA CFO Council as you address these issues in your credit union. Over the past twelve months, we have published seven white papers on critical issues (see our web site for details). And our listserv is abundant with timely discussions among our peers. Through the listserv, we are able to network with each other to access input to assist in our decision making.

It is an honor to serve as chair of this unique professional association, and I welcome your comments on the work of the Council at any time. ◆

Scott Waite, SVP/CFO
Patelco Credit Union

In This Issue

Call for league CFO Council exec committee representative

CUNA CFO Council Chair Scott Waite, senior vice president and CFO, Patelco Credit Union, is seeking candidates to serve on the CFO Council's executive committee. The candidate must be the CFO or primary financial officer for a state league, a member or be willing to join the CFO Council, and be willing to assume the responsibilities of the position. Special consideration will be given to geographic areas of the country that best represent the Council's constituent demographics. If you have contact with your league CFO and know of someone interested in finding out more information, please contact Scott at *swaite@patelco.org*. ◆

EYE ON WASHINGTON

House Clears Check Truncation Measure

The House approved the conference report to the CUNA-supported Check Clearing for the 21st Century Act on Oct. 8. The Senate is next in line to consider the measure before the final bill goes to the president for his approval.

"We believe that the check truncation bill is probably one of the most important pieces of legislation to be considered by Congress this year, despite its technical nature," according to CUNA Lobbyist Gary Kohn. "We're pleased that a final bill has been approved in the House and look forward to the Senate passing the conference report as well, and then sending it to the President for his approval."

Earlier this year, two CUNA members testified in support of truncation legislation before the banking committees of both the House and the Senate. Congress was particularly interested in CUNA's views since credit unions have been truncating checks, or share drafts, since they first started offering share draft accounts in 1977.

Although a majority of credit unions already truncate their share drafts, the legislation would also allow credit unions to truncate more frequently and at an earlier stage in the check-clearing process. ◆

From *NewsWatch* 10/19/2003

To follow this issue, see CUNA's legislative issue pages at: *www.cuna.org/gov_affairs/legislative/issues/cta.html*.

Housing Finance Reform

Explanations abound for the House Financial Services Committee indefinitely postponing its scheduled Oct. 8 markup of legislation to reform the oversight of Fannie Mae and Freddie Mac. *American Banker* reported Oct. 9 what the key lawmakers and other officials have been saying about how to approach reform.

Rep. Richard Baker (R-La.) blamed Fannie and Freddie for the delay, saying that from the moment the Bush Administration presented the committee its proposal, Fannie and Freddie lobbyists have "swarmed the Hill and flooded member offices with document after document designed to gut all meaningful reform out of legislative consideration."

In a strongly worded statement, Baker warned that if the Financial Services Committee is unable to mark up a bill next week, he will recommend to Chairman Michael Oxley (R-Ohio) that the committee hold off until the time is right to get the legislation right. If this is the case, he recommends the committee spend time reviewing ongoing investigations over the housing government-sponsored enterprises (GSEs) by the Office of

Federal Housing Enterprise Oversight, the Securities and Exchange Commission, the General Accounting Office, and the Justice Department.

In addition, the Bush Administration withdrew its support for the committee's draft bill. Some blame the Administration for the delay because it asked Reps. Baker and Oxley to deliver a version that did not have enough support in committee.

The bill would create a new independent safety and soundness regulator under the Treasury Department while adding an office at the Department of Housing and Urban Development to oversee Fannie and Freddie's housing mission and new activities. HUD Secretary Mel Martinez issued a statement Wednesday that said keeping authority over new activities at his agency was a mistake, and urged lawmakers to give the proposed Treasury regulator that power.

Moreover, Treasury Assistant Secretary for Financial Institutions Wayne Abernathy said Tuesday (Oct. 7) that the Bush Administration could not support a bill without product approval and less independence.

Key House Democrats concerned with access to housing issues are opposing versions of the legislation that give Treasury exclusive authority.

On the Senate side, Banking Committee Chairman Richard Shelby (R-Ala.) has said that he will seek including the Federal Home Loan Bank System as part of GSE oversight reform. ◆

From *News Now* October 13, 2003.

For more on CUNA Legislative initiatives go to *www.cuna.org/gov_affairs/index.html*

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.

Corporate investing

A council member asks for information on investing limits with corporates. One respondent reports a policy limit of 100% of excess funds, but in practice the credit union invests no more than 50% of excess funds in its corporate. Another uses a guideline of up to three times net capital. And a third credit union limits it exposure to 20% of total assets, and reviews the corporate's call reports quarterly.

ALCO composition

A member's credit union is in the process of reviewing the structure of its asset/liability committee (ALCO), and asks if others have voting board members as part of the ALCO. Some responses:

"We have four board members on the committee, with one as chair of the committee, all with three year terms."

"Our ALCO includes our president/CEO, VP finance, VP loans, VP member services and three board members. We also have a management ALCO including the president/CEO, VP finance, VP loans, VP member services and VP marketing."

"We have five Board members including the chairman, vice chairman and treasurer (the CEO) on the committee. One serves as chair and also chairs the supervisory committee."

"Our ALCO committee is composed of senior management and key personnel from marketing and lending." Our CEO is on our ALCO committee. She is also a voting board member."

Peer ratios/financial data

A member asks what sources credit unions use to get peer financial and ratio data.

One respondent reports using Callahan Peer to Peer, and is satisfied with the service. Another member advises that the Callahan report can be customized for numerous peer groups at an affordable price.

Another member reports that the credit union's auditors have purchased a database called FIRE and are able to run peer comparison reports on information contained in the 5300 report.

Peer data is also available on the NCUA website, but is not updated on a timely basis.

And CUNA offers a program called FAST maintained by Kurt Quickel kquickel@cuna.coop. One respondent reports finding this service helpful, and available on a monthly basis. The service is free to credit unions that provide data.

Bank CDs

For those who invest in bank certificates of deposit, a member asks what kind of limits are placed on the maximum amount at any one institution. The consensus among those responding to this inquiry was a limit of the insured limit of $100,000 per account. However, one credit union's limit is not more than 1% per institution and not more than 10% of assets for CD's. The credit union suggests this is more flexible than a flat dollar limit.

Sharing ATM surcharge/interchange income

A credit union is considering bidding for installation of ATM machines in privately owned locations, and believes that part of the winning bid will be a revenue sharing agreement with the property owner. The member asks what experience others have had in placing ATM's in privately owned areas and what revenue sharing did the credit union offer to secure the location.

Most respondents reported paying a fixed fee or rent amount monthly, without revenue-sharing arrangements. However, one member says profit sharing bidding processes are common at very popular and public sites such airports, malls, and major chain stores. Local businesses, on the other hand, may be happy to offer the service to their customers. If the property owner is confident there will be a large number of financial institutions vying for exclusivity at a facility, the owner will put it up for bids.

CURRENT AFFAIRS

As Spreads Shrink, CUs Explore Other Ways to Generate Revenue

Yield on loans and surplus funds continues to decrease

By Rick Uhlmann

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 finding it necessary to rely more on fee and other income to bolster their bottom lines, according to Janet Randall, assistant vice president of the CUNA Mutual Group, Madison, Wis. She spoke recently at CUNA's Future Forum.

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%.

"Gone are the days when the question was 'to fee or not to fee.' The question today is, 'where can I generate the fee income I need to improve my bottom line?'" said Randall. "Credit unions need to look at different areas, such as member services or lending, during these times of fierce competition and decreasing net interest income."

In 2001, Randall said, net interest income averaged $3.58 for every $100 of assets—the lowest in credit union history. "To put this in perspective, 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," Randall added.

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," Randall said.

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, Randall said. Examples are fees on e-checks, debit cards, non-member check cashing, ATMs, and payroll cards in some areas.

Credit cards, student loans, and auto loans 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. "Mortgage and home equity loans are the most efficient ways for members to borrow, and the most powerful method of developing 'primary financial institution' [PFI] status with a member," Randall said. "Surveys show that 70% of those members with a mortgage or home equity loan through their credit union identify that credit union as their PFI. Those loans deepen the member relationship."

Important in deepening that relationship is getting a line of credit extended to members. "Preferably, you want to do that at the time of the first mortgage. It's important to open that line of credit, but just as important is getting the member to borrow on it," Randall said." And you need to make sure the channels are in place for easy access."

Lending protection, including credit insurance, is another way to add to the loan yield. New on the credit union lending protection scene is debt cancellation, Randall said. "Because debt cancellation is a lending product, and not insurance, it's often easier to offer and administer to members. Debt cancellation offers credit unions flexibility in providing various protection programs that are managed by the credit union, just like other loan products."

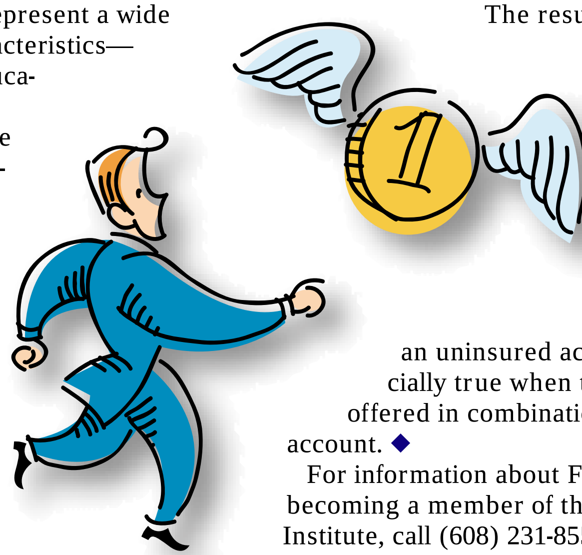
Non-interest income has become necessary for credit unions in today's marketplace, Randall added. "In order to remain financially viable, credit unions must weigh all revenue options available to them, and then decide which ones fit best for their members and the credit union." ◆

From *The Point for CU Research and Advice*
October 13, 2003

Uninsured accounts: answer to capital needs?

As member-owned financial institutions, credit unions are limited in their ability to attract new capital to underwrite growth. In a new report sponsored by the Filene Research Institute, authors Jinkook Lee of the Ohio State University and William A. Kelly Jr. of the University of Wisconsin-Madison evaluate how members feel about uninsured accounts paying a higher dividend than insured accounts. One such product would have appeal to more sophisticated consumers, according to the report entitled *"Uninsured Accounts: An Assessment of Member Interest."*

The authors interviewed 240 members of a credit union in the Southeast, then asked each interviewee to fill out a questionnaire. The members in the sample represent a wide mix of demographic characteristics—age, ethnicity, gender, education, income, and wealth. They also represent a wide range of other characteristics, such as knowledge of federal deposit insurance, knowledge of savings and investment products, attitude toward risk, and openness to new financial products.



Members in the sample received information about a prospective new uninsured CD product. Four groups of 60 members each received varying information about the product. The control group received only a description of the product. A second group received comparable interest rate information in dollar amounts. A third group received information on the rate of credit union failures that would have caused a loss on uninsured shares. And the fourth group received information on both returns and risk. The additional information proved critical to member responses. In the control group, only 13% indicated they'd be likely to use the uninsured product. That figure jumped to 40% and 47% for the second and third groups respectively, and to 87% for the fourth group.

The results suggest that if presented with the right information in the right way, a substantial portion of members would be open to using an uninsured account. That's especially true when the product is offered in combination with an insured account. ◆

For information about Filene studies or on becoming a member of the Filene Research Institute, call (608) 231-8550 or visit on-line at *www.filene.org.*

Economics and Strategic Implications: A Reality Check for Credit Unions

At the recent CUNA Operations Council Conference, CUNA's Mike Schenk, Vice President of Economics/Statistics, and Jane Wood, Executive Vice President, Wescom Credit Union, gave attendees a good dose of economic theory and its real-life implications on credit union operations.

To some, understanding economics is like navigating without a map. So, the challenge presented to conference goers, "Stand up, close your eyes, and point north," got a big chuckle.

When their eyes opened, 90% were pointing every which way but north! The moral - know where you're going before you make any plans.

This workshop's goal was to "help orient and stay on track through the economic pressures that are affecting our industry."

The economic theory presented made good sense and the reality check provided a frame of reference for the challenges facing our industry.

The Economics

Our nation's economy is a strange thing. Recessions in the 1980s and 1990s bear no resemblance to recent economic downturns. And, this "new economic reality" has had a tremendous effect on our planning processes for current and future years. Credit union's are scrambling to make sense of where they are and where they want to go.

Bottom line - the credit union industry will be subject to the whims of continued, strange economic forces through 2003 and 2004. So, here's what to expect:

- **Operating Environment:** Savings growth will stay strong but gradually slow down while loan growth will strengthen through 2004. Short-term interest rates will remain very low.
- **Declining yield on assets:** Rates will go higher but asset distribution will shift to lower-rate investments.
- **Declining cost of funds:** Rates will stay low and distribution will continue to shift to low-cost savings products.
- **Rising provisions for loan loss**: 2003 will see higher bankruptcies and charge offs which should begin to moderate in 2004.
- Lower operating expense to average asset ratio: Savings growth will increase assets faster than the growth in operating expenses.
- **Higher fee income:** Credit unions will continue to find alternative sources of income. NSF, late payment, and mortgage origination fees should remain strong in 2003, and then begin to slow in 2004.
- **Other financials:** Look for higher return on assets and lower capital to asset ratios. ◆

The Reality Check

At Wescom Credit Union, it is clear the standard operating procedure of gathering deposits then making loans is not holding true in this new economic reality. Members want mortgages, they don't want CDs, and the credit union needs more income. So, here's Wescom's reaction to:

- **Recent mortgage growth:** With increased demand, Wescom has had to balance interest rate and credit risks. To check interest rate risk, 40-50% of production is sold while servicing is retained. Low LTVs offer protection against credit risk, which balances against changes in home prices and high unemployment.
- **Declining mortgage volumes:** The key is to have the ability to move the right people at the right time. Front line staff was redeployed to handle the volume and then redistributed as volume slowed. In addition, the credit union looked for ways to increase ARMs and wholesale lending opportunities.
- **Higher market interest rates:** Credit unions can benefit by the lag in re-pricing core deposits and increasing variable rate products.
- **Savings growth:** There is a need to have branches develop brokerage opportunities. Savings growth forces strategic liquidity decisions for short and intermediate cash flow. A well-structured investment portfolio and balance sheet will support this outflow.
- **Fee income:** Credit unions must offset declining yield spreads. Wescom took a hard look at loan and deposit fees, loan sales and servicing income, and brokerage income.
- **Net worth:** Credit unions must stay well capitalized by adjusting averages to be more in line with other financial institutions, protecting credit quality through proactive interest rate risk management, and managing capital investments.

Both speakers agree—credit unions need to find ways to navigate the new economic terrain by managing their balance sheets, maximizing resources, and working smarter. The road will not be smooth, but smart planning may even out some of the rough spots. ◆

Brenda Dunbar
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Click on *http://buy.cuna.org/download/budget04_tips.pdf* for a free *Budget 2004 Tips & Trends* sheet.

CUNA CFO COUNCIL

NEWS

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