CUNA CFO COUNCIL

NEWS

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AN ELECTRONIC REPORT FROM THE CUNA CHIEF FINANCIAL OFFICER COUNCIL

Payday advance and check cashing pay for themselves

Credit unions that offer payday advances and check-cashing services are discovering that these services generate enough revenue to pay for themselves. In some cases these services underwrite the operating costs of transaction-heavy branches in low income and minority neighborhoods. At the same time, they offer significant savings for members and reinforce the message that the credit union is on their side.

For example, State Employees Credit Union (SECU), based in Raleigh, North Carolina, recently introduced Salary Advance, an unsecured line of credit for up to $500 at 11.75 percent interest. This alternative to payday lending has caught on quickly. In one recent month, the credit union made almost 10,700 Salary Advance loans for a total of $4.2 million. The fee for an average $400 loan works out to just under $4, compared to the $40 a payday lender might charge, notes senior vice president and comptroller Mike Lord.

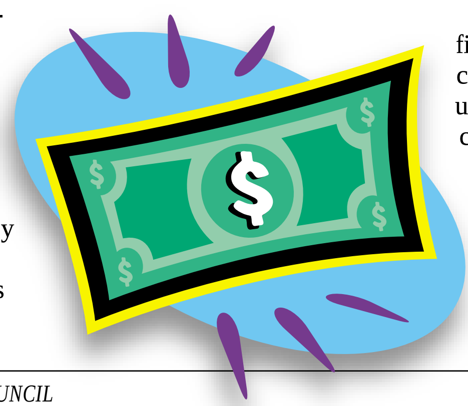
CUNA CFO Council White Paper, *Back to Our Roots: The Case for Credit Unions Offering Payday Loans and Check-Cashing Services*, by Karen Bankston, profiles the alternative financial sector and the way it portrays its customer base. It also examines consumer perceptions that lead them away from traditional lenders toward finance companies charging high fees and rates.

Financial education and counseling is a strong component of credit union efforts to serve lower- and middle-income members. But education can do only so much to protect borrowers most at risk of becoming the target of predatory lenders. Credit union executives expanding services among lower- and middle-income members argue that making low cost micro loans "adheres to the credit union philosophy of people helping people." ◆

This summary is excerpted from the CFO Council White Paper, Back to Our Roots: The Case for Credit Unions Offering Payday Loans and Check-Cashing Services.

Banks and credit unions have different capital needs

A report sponsored by the Filene Research Institute investigates whether the capital needs of U.S. credit unions and banks are identical, given various risk factors involved in their respective operations. In examining the effect of macroeconomic shocks on banks and credit unions, researchers found that differences in governance and policy have a considerable impact on the risks undertaken by banks and credit unions, and produce important differences in their exposure to loan losses caused by macroeconomic shocks.



More specifically, the findings suggest that to create an even-handed regulatory environment for credit unions and banks, credit union capital requirements to cover loan losses caused by macroeconomic shocks should be about two-thirds the bank requirement.

The findings are based on evaluation of the effect of a range of macroeconomic shocks in every state and the District of Columbia during twenty-nine semiannual periods from 1986 to 2000. State-level unemployment rates were used as the measure of macroeconomic shock. Loan delinquencies and loan charge offs at banks and credit unions were examined in each state during each semiannual period. Statistical models that estimate both contemporaneous and lagged impacts revealed the links between unemployment rates and (1) state-level delinquencies and (2) state-level charge offs.

Key research findings

1. Bank loan delinquencies are more than twice as sensitive to the business cycle as credit union delinquencies. A one point increase in the unemployment rate is correlated with a:
   - 23.7 percent increase in bank delinquencies
   - 10.0 percent increase in credit union delinquencies
2. Credit union loan losses are less than two-thirds as sensitive to the business cycle as bank loan losses. A one point increase in the unemployment rate is correlated with a:
   - 30.8 percent increase in bank charge offs over a one-year period
   - 19 percent increase in credit union charge offs over a one-year period

Implications for loan loss

A *mild* recession (2 percent increase in the unemployment rate for one year) would lead to a:

- $11.8 billion increase in bank charge offs
- $441 million increase in credit union charge offs

Public policy implications

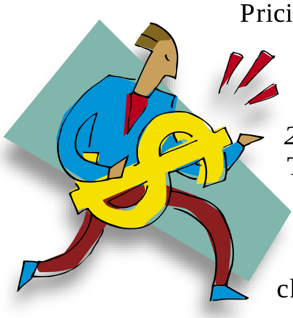
Because credit union loan portfolios are substantially less sensitive to macroeconomic fluctuations than bank loan portfolios, credit unions need less capital to protect themselves from loan losses. This strongly suggests that regulators should treat credit unions differently than banks when determining capital adequacy.

Both banks and credit unions do need capital for purposes other than possible loan losses that occur in a stable macroeconomic environment. Capital cushions losses from investment defaults, mismatched maturities of assets and liabilities, interest rate changes, and loan losses from non-shock events. However, regulations generally prohibit credit unions and banks from taking significant investment default risks and from severely mismatching maturities on assets and liabilities. Required loan-loss provisions protect against normal loan losses.

The implications for public policymakers are clear: banks and credit unions differ significantly in their sensitivity to business cycles. These differences can provide legislators and regulators with an appropriate rationale to rethink the basis for capital requirements, and judge each type of financial institution on the merits of its capital needs, rather than as identical organizations. For credit unions, the research opens avenues to achieve reasonable capital levels without creating new infrastructure or capital programs. ◆

This article is excerpted from the Filene Research Institute Monograph, Differences in Bank and Credit Union Capital Needs, *by David M. Smith and Stephen A. Woodbury. For more information, call the Filene Research Institute at (608)231-8550, or visit online at* www.filene.org.

Pricing strategy is key to financial health



Pricing will be the key to the financial health of credit unions and other depositories in the new millennium, according to a new CFO Council White Paper, *Pricing: 21st Century Financial Service Paradigm*. The key to pricing is understanding the theory, tactics, history, and effective implementation of pricing for depository services, says author Mike Moebs, chairman of Moebs $ervices, Inc., an economic research firm in Lake Bluff, Illinois.

The theory of depository services pricing goes beyond basic microeconomics of volume and price. For services, especially financial services, non-interest loan costs, deposits, competitive position, relationships that incorporate loans, fees, value, utility, quality, and usefulness of the service need to be combined.

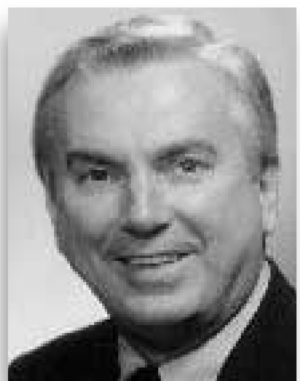
This theory grounds the credit union in the fundamentals, which it then must consider when choosing price tactics. The basic price tactics are fees, rates, and balances, along with the practical option of electronic self-service. All of these must be part of the basic theory when initiating a price, Moebs argues.

Competition driven by baby boomer demand tends to force lower margins. A credit union's choices then become to generate more fee revenue, reduce expenses, or go to a strategic arrangement of combining price, especially fees, with electronic self-service to reduce expenses—substituting member self-service for credit union labor.

Training staff to train members to avoid fees by using electronic self-service is a viable strategic direction that will at least maintain the bottom line, no matter what happens to net interest margins. As with current-day gas stations, credit union managers need to offer two choices: self-service and full-service. ◆

This summary is excerpted from the CFO Council White Paper, Pricing: 21st Century Financial Service Paradigm, *by Mike Moebs.*

Dollar calls for diligent management



Federally insured credit unions with over $50 million in assets showed a continued increase in deposits during the first quarter of 2002, according to newly-compiled NCUA call report data. NCUA Chairman Dennis Dollar told the CUNA CFO annual conference in Williamsburg, Virginia that "diligent management has been demonstrated through both a recession and the early stages of a significant flight to safety."

"That same level of diligent management is now required as credit unions face ongoing deposit growth at a time of decreased return on both loans and investments," said Dollar. "Credit unions are uniquely positioned to face this challenge with capital at its highest dollar value in history; however, the challenge is real nonetheless. Deposit growth is outpacing loan growth and investment income is down. Asset-liability management is crucially important in these times."

According to first quarter 2002 call report data for credit unions with assets in excess of $50 million, shares rose $20.3 billion or 5.63 percent in the first quarter. Loans increased $2.7 billion or 0.99 percent. Total net worth for credit unions in the category of over $50 million in assets increased by $1.1 billion or 2.64 percent since December 31 to its highest level in history at $44.5 billion, although the significant increase in deposits resulted in a decrease in the average net worth ratio from 10.50 percent at the end of 2001, to 10.24 percent at the end of the first quarter of 2002.

Assets in credit unions with over $50 million in assets increased $21.6 billion or 5.22 percent. The number of credit unions in the category of over $50 million in assets increased from 1,556 at the end of the first quarter in 2001 to 1,677 at the end of this year's first quarter.

Unsecured credit card loans and member business loans showed an increase in delinquency rates compared to the prior year because they are more sensitive to an economic downturn. However, overall loan delinquencies as a percentage of total loans decreased from 0.68% at the end of the first quarter in 2001 to 0.63 percent at the end of the same quarter this year. The net charged-off loan ratio increased from 0.41 percent to 0.49 percent in the same quarter comparison of 2001 to 2002. A substantial 38.83 percent of those charged off loans resulted from bankruptcy filings, an increase of 13.78 percent from the same period last year.

"Even as all economic indicators show that the recession is coming to an end," said Dollar, "history has shown us that some lingering negative results do not reveal themselves for a few quarters. We are going to continue to watch these numbers and encourage credit unions to do the same. Again, the name of the game is diligent management."

Dollar called "an impressive sign of proper marketplace response" the fact that net margins of reporting credit unions actually increased by two basis points even as interest income decreased significantly from 7.23 percent at the end of the first quarter of 2001 to 6.05% in the same period this year. The slight increase in net margin resulted from a corresponding decrease in the average cost of funds from 3.72 percent last year to 2.52 percent this year.

"Credit unions are responding to the marketplace even as they make solid business decisions," said Dollar. "This type of balance is crucial. We commend credit unions for this approach and encourage them to continue it." ◆

Influence of credit unions on deposit base is expanding

In his address to the CUNA CFO Council annual conference, NCUA Chairman Dennis Dollar also observed that while credit unions control only 3 percent of the deposit market, they exert a great deal of influence on the other 97 percent of the deposit base. "Credit unions have come of age politically," Dollar told members of the council last month. "You give consumers a choice. Don't you think banks would charge another 100 basis points if they didn't see credit unions charging 6.9 percent?"

Dollar congratulated credit unions for their success and noted it is reflected in the CFO position, which has evolved and grown from accountant to controller, to chief financial officer. "You are a partner with NCUA. Your roll is to ensure safety and soundness," Dollar said.

Dollar used the speaking engagement as an opportunity to continue his agenda for change, promoting Regflex, incidental powers, risk-based scheduling, and risk-based examinations. And he reported that the agency has trimmed thirty-six full time positions from its budget and would likely eliminate another fourteen to sixteen positions by next year, putting NCUA below 1992 staffing levels. "What other [government] agency can say that?" he asked.

"Regflex is not deregulation and I am not an advocate of deregulation," he said. Regflex is not more regulation either; it is "effective" regulation.

Dollar noted that consumers are the ultimate regulators of credit unions and the marketplace, and that they are very concerned with safety and soundness. "They want to know, when they put the dollar in, is the dollar coming out," he said. As Will Rogers once noted, he wasn't so concerned about a return on his money as he was about a return of his money.

Dollar called on credit unions to stop fighting among themselves. Members receive five to ten promotional mailings a week from banks, insurance companies, brokerage houses, and other traditional and nontraditional financial service providers. Credit unions are wasting their energies with battles between big and small, federal charter vs. state charter, occupational vs. community common bond.

What credit unions really have to worry about is service, Dollar suggested. "Ask yourself, why did the member leave?" he said. With only 3 percent of the deposit base and nearly one-third of the nation's population ($80+ million) being members, there's a lot of business going elsewhere.

"Whatever services you provide, you must provide them better than anyone else," Dollar said, "or members will regulate with their feet."

He called upon CFOs to protect the integrity of the credit union, to look forward and protect the membership from a safety and soundness perspective. "Our job and yours is not to avoid risk but to manage risk," he said. ◆

Regional roundtable discussions coming to New Jersey

The CUNA CFO Council will host a one-day conference devoted to roundtable discussions and an economic outlook on credit union financial management strategies, Wednesday, October 9, 2002. The roundtable, co-sponsored by the New Jersey and Oklahoma Credit Union Leagues, will be held at the New Jersey League, 299 Ward Street, Hightstown, New Jersey. Cost is $50 per person.

The conference will feature panel discussions on regulatory issues with Hal Krause, NCUA supervisory examiner and Dino Cerquetelli, NCUA field examiner; and economic and investment insights with Brad

Stewart, vice president, Mid-Atlantic Corporate Federal Credit Union, Middletown PA, an overview of asset-liability management strategies; and a discussion of conference sessions with Colleen Murphy, Oklahoma League vice president and CUNA CFO Council executive committee member.

Leagues participating in this roundtable conference include New Jersey, Pennsylvania, Connecticut, Maryland, New York and Delaware. For more information call 1-800-356-9655; for program content, dial extension 4141; for registration information, dial extension 4074. ◆

Recognition program debuts

In a new program of the CUNA CFO Council, members were recognized for participation in a special ceremony at the membership luncheon in Williamsburg. New members received an engraved pen, members completing one year's service a membership pin, and members achieving five or more years a pin set with five stones.

"The recognition awards serve as a tangible proof of the loyalty and dedication of council members," says Council Chair Scott Waite, SVP-CFO, Patelco Credit Union, San Francisco, CA. "The awards also acknowledge dedicated service to the council and the credit union financial community."

Waite points to the recognition program as a way to demonstrate that participation in the CUNA CFO Council is a unique experience, one that provides education, professional development and networking opportunities to every member. Waite and the executive committee were determined to distinguish the council as an affinity group that members value highly.

"We have people who have been with the organization for many years," says Waite, "and we also have brand new members that attest to our recruiting ability. Lapel pins give members both recognition and the opportunity to explain the role of the CUNA CFO Council to those who may inquire about the significance of the pin."

A one year membership pin signifies recommitment to the council; and a five year pin recognizes long term participation. At this year's conference, thirty-nine individuals were honored for five years membership, and eighty members completed one year. Waite says that it's his hope that the recognition program will become an annual tradition. ◆

CFO conference gives "best value for the dollar"

This year's CUNA CFO Council annual conference in Williamsburg, Virginia received high marks from participants. For charter member Mike Burch, CFO of Crane Federal Credit Union, Crane, IN, the conference was a first. Burch praised the economic information, networking, and educational programs offered at the conference. In addition, Burch said, "council leaders made me feel comfortable and welcome, an attribute that characterizes the credit union family."

Linda Darling, Suncoast Schools Federal Credit Union, Tampa, FL, said: "The CUNA CFO Council continues to be *the* organization for credit union professionals responsible for financial results. In addition to specialized education, the opportunity to meet, share, and learn from other CFOs is invaluable."

Steve Cobb, Kellogg Community Federal Credit Union, Battle Creek, MI, added: "As a newcomer to the credit union community, attendance at the conference was a great opportunity to meet my peers, discuss common issues, meet vendors and receive valuable education."

And Robert Larson, Affinity Plus Federal Credit Union, St. Paul, MN, remarked: "This conference offers the best value for the dollar. I can't wait until next year's meeting. It's a great opportunity to network with fellow CFOs." ◆

WELCOME NEW MEMBERS

The CUNA CFO Council has added a total of seventeen new members, bringing our total number of members to 413, a record breaking year. By joining their colleagues on the council, these individuals have demonstrated their commitment 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.

Terrance Borreson
Arkansas FCU
Jacksonville, AR

Sarah Brower
Tech FCU
Roanoke, VA

Joann Brown
Northern Star CU
Portsmouth, VA

Chris Cardwell
SNCCU
Beaverton, OR

Donna Cessna
Meadville Area FCU
Meadville, PA

Debbie Cook
Delaware FCU
Dover, DE

Bruce Cotterell
Nassau County FCU
Garden City, NY

Audrey Gentile
FAA Technical Center FCU
Northfield, NJ

Horace Hackney
GTE FCU
Tampa, FL

Patricia Janney
ALO Employees FCU
Albuquerque, NM

Marianne Johnson
Eagle Community CU
Lake Forest, CA

Dennis Loftis
Austin Area Teachers FCU
Austin, TX

David Moore
DM FCU
Tucson, AZ

Mary Lee Nissen
Northwest Resource FCU
Portland, OR

Jay Julius Peitsch, Sr.
Wanigas FCU
Saginaw, MI

Kerri Solomon
Saugus FCU
Saugus, MA

Pamela Turner
UVACCU
Charlottesville, VA

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.
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