STRATEGIC INSIGHTS FOR POLICY MAKERS

Credit Union National Association
CUNA

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Take Responsibility for Your Financial Literacy

Regulators hold volunteers accountable for understanding key measures and ratios that indicate a CU's health.

Picture this scenario: It's time for the annual exit interview with credit union regulators.

You've been told they finished your regulatory exam and have requested the entire board's presence. If this development hasn't already alerted you to an issue, the six regulators awaiting you in the board room does.

You look around the board room and see anxiety in the CEO's face, urgency in the regulators' faces, and a bit of confusion and concern in your fellow directors' faces.

Houston, we have a problem: Your credit union is losing money. Your net worth ratio is taking a plunge, and you're losing assets.

"And," the regulators say, "it's your fault."

This stunning news leaves you with two questions: Why didn't anyone warn me? And why is it my fault if I'm just a volunteer?

Serving as a credit union board member might be voluntary, but the position carries a significant amount of responsibility.

Among the duties NCUA lists in Regulation 701.4 is this little tidbit: Each director, "at the time of election or appointment, or within a reasonable time thereafter, not to exceed six months, [must] have at least a working familiarity with basic finance and accounting practices, including the ability to read and understand the federal credit union's balance sheet and income statement and to ask, as appropriate, substantive questions of management and the internal and external auditors."

DIRECTORS CAN'T WAIT FOR SOMEONE ELSE TO INFORM THEM ABOUT THE CU'S FINANCIAL CONDITION.

Directors don't need to parse out numbers like certified public accountants. But you do need to know your basic ratios—how they work and what they mean—and know enough to be able to ask the right ("appropriate and substantive") questions.

Directors can't wait for someone else to inform them about the credit union's financial condition.

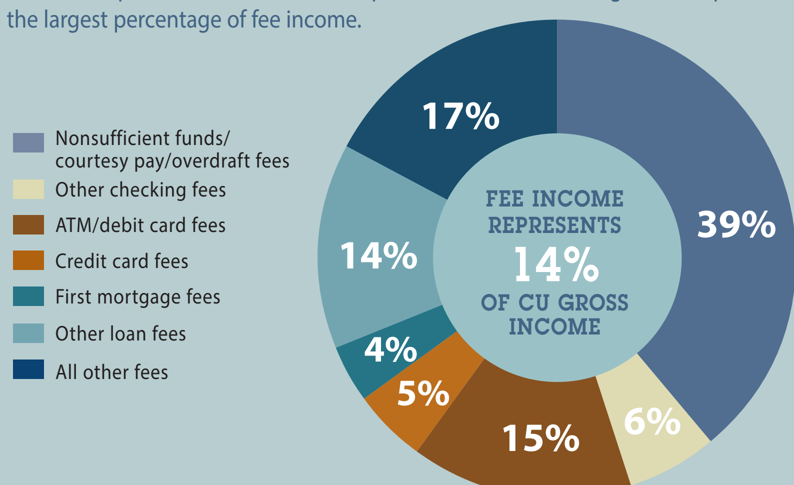
If you serve on a credit union board, you need to ask basic questions such as these—and just as important, be able to understand the answers:

- **Are we financially sound?**
- **Do we have adequate net worth or capital?** How much capital is enough—and if we need more, where does it come from?
- **Is our financial condition improving or declining?**
- **Are we profitable, or profitable enough?** How much profit do we need—and if we need more, how can we get it? Additionally, what elements of income and expense lead to profit?
- **Are we growing?** Are we growing fast enough, or too fast? Are we growing in the right ways?
- **Is our business model working?** Do we understand our business model? And is it designed to give us the profit, capital, and growth we want?
- **Are we headed in the right direction financially?**

QUICK TAKE FOR YOUR NEXT BOARD MEETING

Fee Income Stays Steady

Fee income accounted for 14% of credit unions' gross income in 2016—unchanged from 2014, but up slightly from 12% in 2012, according to CUNA's economics and statistics department. Consistent with previous studies, checking fees comprised the largest percentage of fee income.



Source: *CUNA Fees Report* (cuna.org/fees)

- CUNA Credit Union Finance for Volunteers & Staff School: *cuna.org/cuf*
- CUNA Board Financial Literacy Certificate: *cuna.org/volunteer*

In exactly which direction do we want to go? Against what strategic measures can we compare ourselves, and are we succeeding?

Directors need to see the big picture and understand key measures and ratios.

They also need to have a system to monitor key measures and ratios so they can determine whether the credit union is moving in the right or wrong direction.

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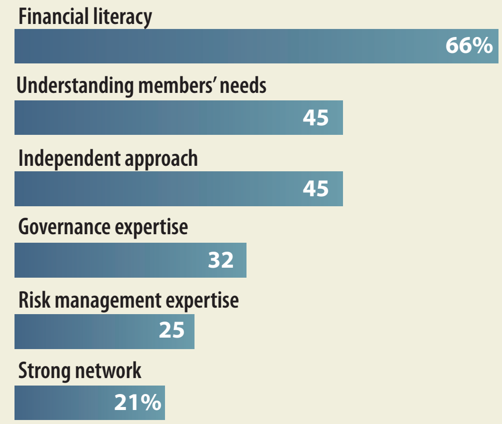
Most Important Skill for CU Directors



Source: *Filene Research Institute* (filene.org)

- CUNA economics and statistics department white paper on NCUA's Corporate Resolution Program: *cuna.org/ncuastabilizationprogram*

Decisions Loom as NCUA Winds Down CRP

CUNA seeks input from CUs on three main policy issues.

CUNA has identified three key policy decisions facing NCUA as it prepares to dissolve the Corporate Resolution Program (CRP), and seeks input from credit unions and leagues as it crafts recommendations for the agency.

NCUA and Congress established the Temporary Corporate Credit Union Stabilization Fund (TCCUSIF) as a means of interim funding after five corporate credit unions became insolvent during the financial crisis.

Federally insured credit unions paid stabilization assessments to assist in repaying those obligations, which also were funded by borrowing against the legacy assets through NCUA Guaranteed Notes and borrowing from the U.S. Treasury Department.

NCUA COULD BEGIN ASSESSMENT REBATES THIS YEAR. CAPITAL REPLENISHMENT WON'T OCCUR UNTIL 2020 OR 2021.

The Treasury has recouped that debt, and the Stabilization Fund has built a positive net position.

NCUA now projects the resolution to cost between $5.5 billion and $7 billion, less than half the original estimates. The agency suspended assessments after 2013, having collected $4.8 billion.

Thanks to these assessments and $5.6 billion in depleted capital from the five corporates, credit unions have overpaid current projected final costs of the resolution by between $3.4 billion and $4.9 billion.

Projections now indicate the National Credit Union Share Insurance Fund will rebate between half and two-thirds of the $4.8 billion of assessments, and will replenish between 15% and 30% of the $5.6 billion in depleted capital.

NCUA could begin assessment rebates this year. Capital replenishment won't take place until 2020 or 2021.

As CRP winds down, NCUA will need to make three important policy decisions:

1. Should the agency merge the National Credit Union Share Insurance Fund and the TCCUSIF this year and begin the process of assessment rebates in the form of an insurance fund dividend? This strategy appears advantageous, but CUNA will evaluate the risks and ramifications to this strategy.

2. Will the agency assess a share insurance premium this year? Even if NCUA doesn't merge the funds in 2017, CUNA economists consider a share insurance premium unnecessary because of the prospect of a considerable capital infusion into the share insurance fund in the next few years from the merger.

3. How should NCUA dispose of legacy assets? As the stabilization program winds down in 2020 and 2021, the agency and credit unions will need to discuss the best course of action.

Credit unions that wish to have their views included in CUNA and league analysis should email *refund@cuna.coop.*

Combat the Rise in Plastic Card Fraud

No easy solutions exist, but following four steps can help you rein in losses.

Retailers and financial institutions alike celebrated a 16% year-over-year increase in e-commerce holiday sales for 2016. But fraudsters were the real winners, with digital fraud attempts growing by an astounding 31%, according to ACI Worldwide.

These figures support a reality that most credit unions find difficult to accept: Experts forecast worldwide card fraud will increase 45% by 2020.

An uphill battle

The growing number of fraud-fighting tools and technologies might lead you to presume credit unions are due a slight reprieve from this threat. Unfortunately, the contributing factors for fraud continue to stack up against them.

The six factors expected to have the largest effect include:

1. Pushing back the fraud liability shift for chip-embedded EMV (Europay, MasterCard, and Visa) cards at gas station pumps to 2020 instead of 2017.

2. For non-EMV merchants, the decision to no longer allow issuers charge-backs for purchases under $25 and to allow issuers to charge back only 10 fraudulent transactions per account.

3. Fallback transactions occur too regularly, eliminating the effect of the liability shift for credit unions. Fallback transactions can occur for a number of reasons, but generally they happen when a chip-embedded card, presented at a chip terminal, cannot be read due to a technical issue with the terminal or chip, resulting in a mag stripe transaction.

4. EMV adoption rates continue to be low for both retailers and financial institutions. Only 7.2% of all card-present transactions between July 2015 and June 2016 were EMV compliant, per EMVCo.

5. More secure mobile payment options aren't as popular among consumers as expected. But use is increasing, with both mobile pay providers and financial institutions starting to offer rewards to increase adoption.

6. Innovation in the card-not-present space isn't hitting the market fast enough. Technologies such as digital CVV codes still aren't cost effective, and vulnerabilities in 3D-Secure—an authenticated payment system designed to improve online transaction security—continue to result in losses.

What CUs can do

While the situation seems dire, following these four steps will position your credit union well:

1. Define success. Find the right balance between security and member experience. To gain insights, leverage peer benchmarking and networks, such as the options CUNA Mutual Group offers.

2. Partner with your processor. Ensure that your expectations align and that you have the information needed to evaluate fraud cost versus the cost of solutions. Recognize the impact of increased spending on your total fraud numbers.

3. Consider adopting EMV or expediting adoption. While it isn't perfect, EMV is still your credit union's best bet in the fight against card-present fraud. Due to the continued increase of fraud in this space, some credit unions have gone from reissuing cards at expiration to replacing their entire credit card portfolio at once.

4. Don't take your eye off fraud. Fraud tactics constantly change, which requires credit unions to remain vigilant. Take note of what gets past your fraud controls and make adjustments in as close to real-time as possible.

No easy solutions exist in the fight against plastic card fraud. But by establishing and monitoring results, adopting appropriate technologies, and approving effective policies and procedures, you have an opportunity to change the future.

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- CUNA Mutual Group's Credit Union Protection Resource Center: *cunamutual.com/resources*

■ CUNA Board and Volunteer Training: *cuna.org/volunteer*

Demonstrate Commitment and Inspire Others

These leadership principles from a former CEO stand the test of time.

To survive and thrive in an era of disruption, credit union volunteers and staff need to embrace a four-letter word—love—as their chief business principle, says former credit union CEO John Tippets.

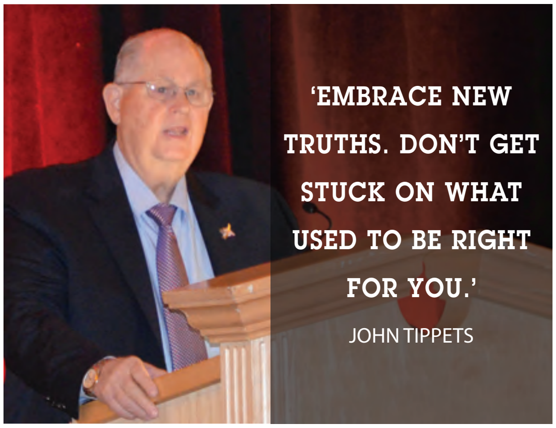
Drawing from one of his heroes, legendary UCLA men's basketball coach John Wooden, Tippets underscores the value of loving what you do, whom you work with, and the people and causes you work for.

That doesn't mean accepting subpar results, Tippets emphasizes, but rather demonstrating a genuine commitment to your mission and inspiring others to do the same.

"Leaders are best if they're hardly noticed," Tippets says, "and when it's all over and you've met your goal, everyone feels 'we' did it."

In a presentation at CUNA's Supervisory Committee and Internal Audit Conference, Tippets presented a series of leadership principles that apply in the board room today as much as ever, including:

- **Do the right thing.** Resist the temptation to take shortcuts or rationalize imperfect choices. "No good deed goes unpunished," he says, "but do the right thing anyway."
- **Demonstrate integrity of process.** "Listen to and value the opinions of others, particularly those with whom you disagree or those who might have a different perspective," he says. Seek out new information and understand the magnitude of decisions.
- **Build trust.** As the financial crisis and a series of banking scandals has demonstrated, trust is hard to earn and easy to lose. "It's a sacred thing to have and hold and make sure you continue to earn," Tippets says. "Trust is saying what's on your mind, talking straight and with tact, and showing genuine caring."
- **Embrace humility,** which Tippets defines as the ability to look for good in others, particularly their good ideas you might not have considered. "Embrace new truths," he says. "Don't get stuck on what used to be right for you."
- **Hire happy people.** The most common element in employees Tippets had to replace was unhappiness, which they reflected in their work and their performance as teammates. "A happy person isn't a person in a certain set of circumstances but a person with a certain set of attitudes," he says.
- **Walk the walk.** When you're a leader, people will watch how you act and talk. "You are the water at the cooler conversation," he says. So, live your principles.
- **Respect others,** especially when they are different.



"We should appreciate diversity, draw on a multitude of life experiences, and look at them as our eyes to other segments of our community," he says.

- **Have vision.** Few of us have prophetic vision, but all of us can exercise "peripheral vision," Tippets says.

That means observing the events occurring around us in our communities and at other credit unions, and understanding the business and social climate at the macro level by communicating with others and reading publications that illuminate trends.

To illustrate this point, Tippets showed a photo of a safari tourist gazing into the distance, while a lion sat just yards behind him. "Vision partly depends on which direction you're looking," Tippets says. "Turn around and see what's going on in other areas."

- **Believe in the power of perseverance.** Tippets' father survived a plane crash that left him stranded for 30 days in Alaska in the wintertime. His drive enabled two other men to survive as well. "Perseverance is how we deal with difficult times," he says.

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