STRATEGIC INSIGHTS FOR POLICY MAKERS

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Favorable Forecast for Loan Growth

4 factors lead CUNA economists to take a rosy view of the 2018 lending outlook.

While the U.S. economy is growing, more observers are voicing concern over the outlook in 2018.

Market interest rates are drifting up. The benefits of infrastructure spending and comprehensive tax reform—baked into many earlier forecasts—seem less likely with each passing day. And there's heightened potential for trade war and geopolitical risks.

Even so, as CUNA economists peer into the crystal ball, they see a rosy future for lending opportunities, according to vice president of research and policy analysis Mike Schenk.

CONTINUED HEALTHY PORTFOLIO EXPANSION SEEMS A NEAR CERTAINTY.

In 2017, credit union loan portfolios are on track to increase more than 10% for the fourth consecutive year. More important, while the overall rate of growth might slow a bit, continued healthy portfolio expansion seems a near certainty in 2018.

It's also worth noting that the growth credit unions are experiencing substantially exceeds the overall growth in household borrowing.

According to the Federal Reserve, aggregate consumer credit outstanding (defined as revolving and nonrevolving loans to consumers, excluding home equity loans and second mortgages) increased 5.9% in the year ending July 2017. In contrast, over the same period, these loans grew an astounding 14.1% at credit unions—which means credit union loans aren't simply growing quickly, they're pushing the movement's market share of consumer credit higher.

Nowhere is this more obvious than in vehicle lending. Credit union market share of vehicle loans increased from about 22% at the end of 2011 to 30% by midyear 2017.

In the November issue of *Credit Union Magazine*, Schenk cites four reasons to expect continued success in 2018:

1. Robust outlook for jobs, income. The U.S. unemployment rate finished August at 4.4%, down 0.5% from year-ago levels and well below the 10% cyclical peak in October 2009.

The U-6 unemployment rate—which accounts for those who have become discouraged, as well as those who are working part time but want full-time work—finished the month at 8.6%. That's more than one full percentage point lower than its year-ago reading.

Most economists believe labor markets are now near full employment. Bureau of Labor Statistics data shows the total number of job openings nationally is at an all-time high.

And it's also reflected in fast-rising incomes. The Census Bureau recently reported median household income hit $59,000 in 2016, a record high and a 3.2% jump compared with 2015. That means median income increased 2.5 times the rate of inflation during the year.

2. Healthy consumer balance sheets. Household assets' value has been rising quickly. The stock market is bumping up against all-time highs, and current valuations are well above prerecession levels.

The S&P 500 was up 12% through September and 20% over the past 12 months. Roughly 55% of credit union households have an ownership interest in the stock market.

Housing also has been on a tear. According to the Federal Housing Finance Agency, U.S. home prices are up 4.7% in 2017, and rose 6.6% in the year ending June 2017. At midyear 2017, average home prices were 14% above prerecession levels. Importantly, nearly 70% of credit union households own a home.

Good news also exists on the liability side of the

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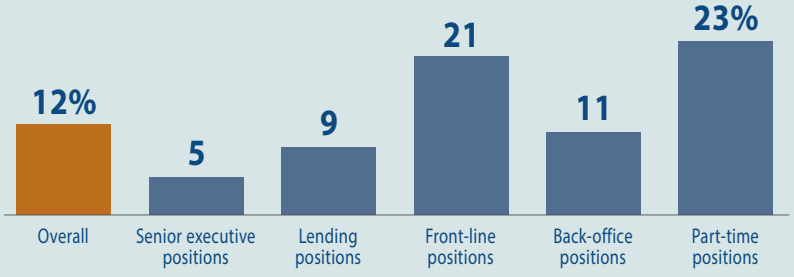
CU Turnover Rates

Entering 2017, the turnover rate at credit unions with assets of $1 million or more was 12%, which is down slightly from 16% the previous year, and in line with the 2015 figure of 13%, according to CUNA's 2017-2018 Turnover and Staffing Report.



Source: *CUNA's 2017-2018 Turnover and Staffing Report* (cuna.org/research)

- CUNA research and policy analysis: *cuna.org/economics*
- CUNA Lending Council: *cunacouncils.org*

consumer balance sheet. Household debt as a percent of disposable income hit an all-time high of 130% during the housing boom, but has trended down to 100%, a level last seen in 2002.

This combination of rising asset values and declining liabilities means household net worth is increasing. In fact, net worth as a percent of take-home pay finished the second quarter at 652%, an all-time high.

3. Continued pent-up demand. While spending and borrowing have been on the rise, it's abundantly clear that the choppy, uncertain nature of the recovery combined with an excruciatingly slow labor market recovery are keeping many consumers on the sidelines.

Bureau of Economic Analysis statistics indicate the average age of consumer durable goods remains close to post-World War II highs.

The U.S. Department of Transportation reports the average age of passenger cars and light trucks has reached an all-time high of 11.6 years, up from 8.5 years in 1996 and 9.9 years in 2006.

4. Affordable credit. While the Federal Reserve has been raising its federal funds interest rate target, the increases have been modest and manageable.

CUNA economists expect the Fed to remain engaged, increasing market interest rates through the end of 2018. But the increases should be relatively small, and therefore unlikely to choke off demand in any significant way.

Combine that with rising incomes, and the result suggests strong borrowing in the future.

Strong CU lending performance*

13% Rise in consumer credit

8.1% Growth in credit card portfolio balances

16.9% Member business lending portfolio increase

10.3% Bump in first mortgages

** for the 12 months ending June 2017*

Rochdale Paragon Group, a CUNA partner: *cuna.org/erm*

Highlights From CUNA GRC Leadership Institute

Governance, risk, and compliance practice improves operational and strategic performance for organizations.

An effective governance, risk, and compliance (GRC) program is an organization-wide enterprise—a part of a credit union's culture.

GRC should improve overall performance both operationally and strategically, says Tony Ferris, CEO of Rochdale Paragon Group, a CUNA partner.

He and other subject experts addressed the CUNA Governance, Risk Management, Compliance Leadership Institute in Denver.

Benefits of GRC programs

Some outcomes, according to Ferris, that GRC programs help credit unions achieve:

- **Capital allocation.** "When you get down to it, capital and resource utilization that optimizes the risk-reward scenario is the end all, be all of an effective GRC program," Ferris says. "It's very strategic in nature."
- **Operational execution.** Ferris says credit union GRC programs should engage the whole organization, proactively sharing information and breaking down silos where tasks are the focus rather than organizational objectives. "The idea is to be proactive rather than reactive," he says.
- **Defining workplace culture.** "Every credit union has its own culture," Ferris says. "The question is whether that culture is driving you toward your goals and objectives.

"Are people bringing you the information you need to move the organization forward—or are they simply keeping their heads down and just doing the job in front of them?"

- **Identifying opportunities.** "If I miss an opportunity, is it going to cost me my job or result in losses?" Ferris asks. "Probably not. But it's guaranteed that your organization is worse off. A risk-averse or siloed approach hinders innovative and advanced decisioning.

"The decisions you make today determine how relevant your credit union will be in the future. How many opportunities is your credit union missing?"

- **Strategic focus.** Ferris says it's part of GRC's responsibility to keep the management team and the board focused on what's important strategically.

Risk programs, while they have an operational component, are ultimately focused on what has to go right to achieve the objectives of the organization at the strategic and mission levels.

- **Cost savings.** "We can walk through our organizations and we see inefficiencies," he says. "But without an integrated and holistic approach, you will be hard-pressed to fix them. Coordinated risk, compliance, and audit programs capture information once, fill knowledge gaps, and target those items that are truly important."

■ **Examination strength.** "A nice, clean exam" is among every CEO's and board's biggest expectations.

GRC helps to ensure "there are no gaps in the process," Ferris says. "Most important, it demonstrates the capabilities to effectively and holistically govern, identify, analyze, and take effective action in a manner that is appropriate given the level of risk.

"In the end, our programs and cultures need to flip the equation to minimize tasks and maximize the intelligence we garner from the organization as a whole," Ferris says. "Holistic programs create organizational capabilities that keep meeting the business objectives front and central rather than chasing work. We need to get back to running the business and not working to simply check the box.

CFPB wants to see how you track and manage complaints

The advent of the Consumer Financial Protection Bureau (CFPB) has turned the consumer complaint process into a compliance event.

It's no longer enough to take consumer complaint calls and strive for good service, says Jared Ihrig, CUNA's chief compliance officer.

"The CFPB wants to see how you're managing those calls and how you're tracking them," he says. "They want spreadsheets and pie charts that show when the calls came in and how long it took to resolve the issue, and if the error was extrapolated across the membership and remediated with all the members who had the same issue.

"They want to know if you changed your policies, procedures, and product offerings so the same complaint does not happen again."

CFPB is closely scrutinizing regulators to ensure they're documenting these issues.

Credit unions must establish a channel through which complaints can be tracked whether it's a phone number, e-mail address, or a web address.

"You also must delineate between complaints and inquiries," Ihrig says.

A complaint that comes in repeatedly might indicate a weakness in the credit union's compliance management system.

"That's what the regulators look for," Ihrig says. "If they see 50 overdraft complaints, they are going to see a deficiency and ask how you plan to address that deficiency."

Today's chief risk officers need a breadth of skills

Brian Hague, senior risk intelligence adviser at Rochdale Paragon Group, offered a breakdown of the skill set required for today's chief risk officer.

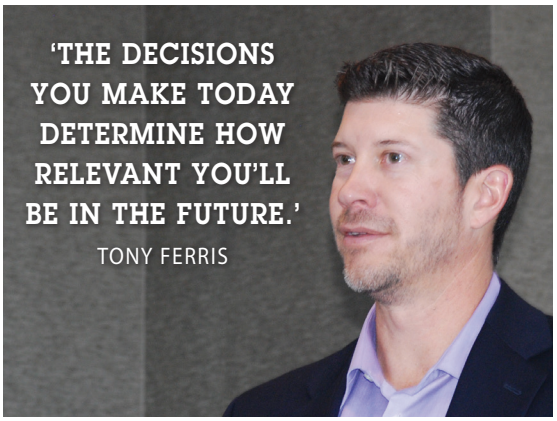
Those skills include:

■ **Leadership.** "If properly structured, the risk officer is going to be one or of the executives that leads the business forward," Hague says.

■ **Business.** "This means understanding limitations, opportunities, goals, and objectives," Hague says. He predicts that the career path to the CEO's office may increasingly go through the chief risk officer role "because of the breadth of knowledge it offers."

■ **Ability to measure risk vs. reward.** "That means that we can tangibly and meaningfully understand the risks that we are taking," Hague says. "That means understanding our tolerance metrics that apply to the business at hand and understanding that limiting risk too much isn't a good thing."

■ **Communication.** The chief risk officer must interact with a wide variety of people, including the rest of the executive team, the board of directors, middle management, and even staff, regulators, and auditors. As a result, communication is a key skill they need to possess.



■ **Technology.** Much of risk measurement, such as stress testing, is driven by technology, Hague says.

■ **Strong financial background.** "This is just a function of who we are," Hague says. "We are financial institutions. You have to understand how we work."

■ **The ability to influence.** "If properly structured, this role will be allowed to help the credit union shape its direction and persuade other senior managers that we might have to take more risk in some areas and less risk in others," he notes.

■ **Big picture perspective.** The chief risk officer must be able to remove themselves from "the weeds" of the compliance and risk. They must take a 30,000-foot view and communicate that view to others, Hague says.

■ **Emotional intelligence.** "Being a chief risk officer can result in turf wars, so it takes a certain amount of emotional intelligence to rise above that," Hague says. "The other executives have to trust the chief risk officer, whether it's other executives, the board, or staff members."

■ **Change agent.** "The chief risk officer might influence the direction of the credit union, and that could actually mean taking on more risk," Hague says.

CUNA compliance resources, including the Compliance Community: *cuna.org/compliance*

- CUNA volunteer resources: *cuna.org/volunteer*
- Stickley on Security: *stickleyonsecurity.com*

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Cybersecurity Requires a Vigilant Board

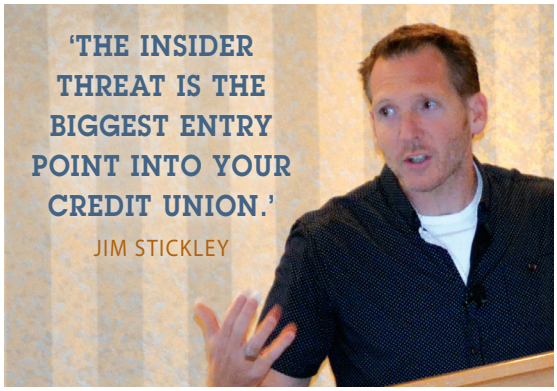
Oversee sound policies and ensure that management and staff adhere to them.

Cybersecurity threats aren't going away—they're only getting worse.

So, credit unions need to update their security policies and procedures regularly because the threat landscape is always changing.

That dreary outlook comes from security expert Jim Stickley, CEO of Stickley on Security.

"Most of the risk comes from employees making



mistakes and doing something dumb," says Stickley, who addressed the CUNA National Credit Union Roundtable for Board Leadership in Las Vegas. "Usually, they're unknowing participants. But the insider threat is the biggest entry point into your credit union."

While credit unions of all sizes are at risk of attack, those above the $1 billion asset mark are especially vulnerable because their networks are more complicated and additional regulations take away the focus that could be placed on security.

Also, even large credit unions tend to have small information technology (IT) security teams, when compared with for-profit financial services companies.

Increasingly, cyber thieves are targeting specific employees, particularly IT administrators, using social networking sites such as LinkedIn.

The board's role in security, according to Stickley:

- **Stay informed** about security changes, both in the industry and at your credit union.
- **Follow** established questions to ensure proper security controls.
- **Approve** the credit union's written information security program.
- **Affirm** responsibilities for the development, implementation, and maintenance of the program; and review a report on the overall status of the program at least annually.

Management should provide a report to the board at least annually that describes the overall status of the program and material matters related to the program, including:

- **Risk assessment process**, including threat identification and assessment.
- **Risk management** and control decisions, including risk acceptance and avoidance.
- **Third-party** service provider arrangements.
- **Results of testing**.
- **Security breaches** or violations of law or regulation and management's responses to such incidents.
- **Recommendations** for updates to the information security program.

Credit unions also should review employees' access to technology, Stickley says.

"Many don't need to be able to receive email at work," he says. "Find out which employee groups need access to email, the internet, and so on. If an employee doesn't need it, turn it off."

MEET THE 2017 ROCK STARS

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