STRATEGIC INSIGHTS FOR POLICY MAKERS

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Expect Solid Loan Growth to Continue

Strong economy and supremely confident consumers play a role.

As the strategic planning season soldiers on, we once again find ourselves wondering if this incredible run of favorable credit union operating results can continue. You're probably having similar thoughts.

For our part, CUNA economists remain optimistic about the future. And we're especially optimistic about credit union lending.

There are two big reasons to be hopeful: The economy is in good shape overall, and consumers are supremely confident.

'THE ECONOMY IS IN GOOD SHAPE OVERALL, AND CONSUMERS ARE SUPREMELY CONFIDENT.'
MIKE SCHENK

Midyear 2018 NCUA Call Report data reflects solid overall results with an acceleration in membership growth, solid loan growth, high asset quality, and strong earnings.

Credit union memberships increased by nearly 4.8 million in the year ending in June—a 4.3% advance. That helped keep loan growth near double-digit levels, with overall loan balances up 9.6% during the 12-month period.

Bottom-line results were solid, with return on assets rising from 77 basis points (bp) in 2017 to an annualized rate of 90 bp in the first half of the year.

The earnings bump was due in part to the National Credit Union Share Insurance Fund equity distribution. But it also arose from broad-based increases in loans: The interest yield on credit union assets grew from 3.53% in 2017 to an annualized rate of 3.68% in the first half of 2018.

Here are two reasons to expect solid loan growth in 2019:

1. Strong labor market. The economy added 134,000 jobs in September, bringing the 12-month total increase to 2.54 million—an acceleration over the full-year 2017 increase of 2.19 million new jobs. It also exceeds the 2016 total of 2.34 million new jobs.

The September unemployment rate declined to 3.7%, its lowest level since 1969.

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—settled in at 7.5% in September, reflecting a 1.1 percentage point decline over the previous year.

Strong labor markets have translated to modestly higher pay for many workers. Average hourly earnings are up 3% in the past year, and the Census Bureau reports inflation-adjusted median household income increased 1.8% in 2017 to $61,372.

2. Household debt. Household balance sheets have never been in better shape: The stock market remains near all-time highs, and home prices are rising at healthy rates; about 6.5% over the past year nationally.

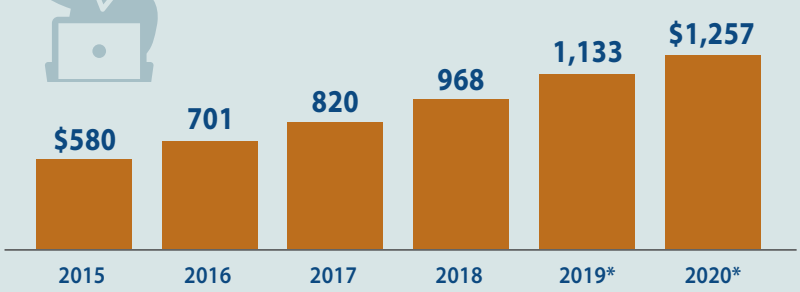
Household debt levels now stand at an all-time high. But household debt as a percentage of take-home pay is now 95%, and it has hovered near a cyclical low for the past two years.

The combination of rising asset values and declining liabilities means household net worth is increasing—quickly. Net worth as a percent of take-home pay is now 683%—an all-time high.

QUICK TAKE FOR YOUR NEXT BOARD MEETING

Synthetic Card Fraud on the Rise

The occurrence of synthetic fraud—using a stolen Social Security number and false personal information to create a fake identity—is on the rise. Synthetic credit card fraud could reach $1.2 billion by 2020, according to Aite Group.



*Estimated
Source: *Aite Group*

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

It's no surprise that increasing wealth is associated with household spending increases and household borrowing increases over time.

We believe the Federal Reserve will continue to raise interest rates, but the magnitude and pace of those increases will be manageable and won't likely cause a significant decline in loan demand over the next year.

What does this mean for credit union loan portfolios? We believe credit union loan growth will remain strong but begin to reflect smaller increases going forward. In the aggregate, we see credit union loans increasing 9.5% this year and 8% in 2019.

Auto loans will continue to lead the way. The average age of cars on the road is at an all-time high of 11.6 years, which suggests healthy underlying demand going forward.

New- and used-auto loans outstanding accounted for 31.6% of all credit union loans at midyear 2018. That's up from 30.3% at year-end 2017 and 22.4% in 2007.

The consultancy IHS Markit projects full-year 2018 new-auto and light-truck sales of 17.2 million units, a 1.3% decline from 2017, with continued softening going forward. The outlook for used-auto lending looks favorable.

Home loan originations also should help credit unions maintain healthy portfolio growth. The Mortgage Bankers Association expects mortgage originations to decline 6.1% in 2018 and a modest 0.9% in 2019, followed by a 2.4% increase in 2020 as slower home price increases help to stabilize affordability.

We expect credit unions to continue to outperform in the mortgage arena. Credit union mortgage originations accounted for only 1.9% of the national total in 2007. That share has increased steadily over the years, reaching 8.2% at year-end 2017 and 8.7% at midyear 2018.

Economic fundamentals are strong. Consumers are engaged, and many seem ready, willing, and able to borrow. Loan growth will almost certainly decline over the next 18 months, but most credit unions should continue to enjoy healthy portfolio increases.

In short, economic fundamentals look solid through the end of 2019. And that's good news for credit union members and for credit union lending operations.

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CUNA Board of Directors Community: *community.cuna.org*

What Directors Are Talking About

Voting for board elections is a hot topic on the community discussion board.

With growing memberships and the increasing cost of postage, conducting board elections with mail-in ballots has gotten more expensive. That left Jean Peterson, first vice chair of the board at $135 million asset Aberdeen (S.D.) Federal Credit Union, wondering whether some credit unions use online voting for their board elections.

Many fellow members of the CUNA Board of Directors Community, an online space for credit union board and committee members to connect with their peers, found themselves in the same situation.

Seattle Credit Union uses a vendor that provides both mail and electronic voting options for the $860 million asset credit union's 49,000 members, says Brandon Ely, vice president of internal audit. The credit union has used Survey & Ballot Systems (SBS) for four years.

The system uploads board candidates' photos and biographies, and it includes a complete membership list and branding. SBS compiles this information into mailed and online ballot forms and compiles the results.

"We get daily reports of both mailed and online votes," Ely says. "Once the election is over, they notarize the results and send us back any 'white mail' where our members handwrote comments to the credit union on the physical ballots."

Do you have something to add to the discussion? Join the community at *community.cuna.org*.

Distinguishing Between Governance and Management

Understand the differences between what drives decision-making.

Show me a consistently high-performing credit union , and I'll show you a high-performing board that understands the difference between governance and management.

These credit unions stand out in so many ways: member impact, profitability, growth, efficiency, and so on. Effective board governance is critical to setting the right tone for management, which then carries over to the rest of the credit union.

The difference

Credit union board governance refers to oversight and decision-making related to the organization's mission, vision, values, and strategic direction. This strategic oversight provides guidance for management to determine and manage activities required to meet the strategic themes the board identifies.

"Management" refers to the short-term decisions and administrative work related to the credit union's daily operations. Management decisions should support or implement goals and values the board defines.

I like to use a nautical metaphor when I provide board governance training: The board sets the destination and the desired arrival time, and it hires the captain (governance). The captain charts the course, navigates the ship, and manages the crew (management).

If the difference between governance and management is so simple to understand, why do so many boards spend so much time on management-related issues?

When I encounter dysfunctional boards that focus too little on governance issues and too much on management issues, it's usually due to one (or all) of these reasons:

- **Habit.** Credit union boards often attract successful people with management experience from their professional lives. Sometimes it's difficult for these directors to "mentally switch" from the management focus at their day job to the governance focus required for their board role. Board chairs should take the lead in communicating and maintaining role clarity when directors' "management" habits get in the way.
- **Lack of knowledge.** Some board members have limited governance experience and haven't received training on the difference between governance and management. This creates a limited understanding or lack of clarity about their role. Board training should explain directors' roles and responsibilities.

'EFFECTIVE BOARD GOVERNANCE IS CRITICAL IN SETTING THE RIGHT TONE FOR MANAGEMENT.'

SCOTT BUTTERFIELD

- **Lack of trust in management.** Sometimes this is justified, and other times it's not. Usually, it just means both parties need to work on building trust. When boards get involved in management details and issues, it sends a clear message that the board doesn't trust management. If the board isn't comfortable delegating appropriate issues to management, it must examine why and address the issue.

Why it matters

Credit unions perform better when they balance governance and management. Generally, board members lack the knowledge, experience, and skills sets required to run a credit union. Boards are designed to govern. To do so effectively, board members should hold themselves accountable for and stay focused on oversight and decision-making related to the credit union's mission, vision, values, and strategic direction.

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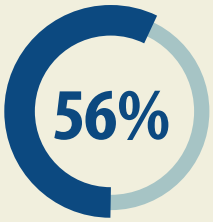
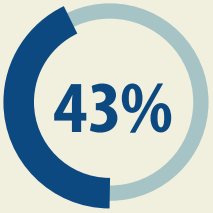
Dynamics Between the Board and Management



Constructively challenge each other in meetings.



Agreement exists between the board and management on their roles.

Source: *McKinsey & Co.*

CUNA Volunteer Conference, Jan. 13-16, 2019, Montego Bay, Jamaica: *training.cuna.org/cvc*

CUNA compliance resources: *cuna.org/compliance*

Balance Risk and Inclusion

Money-service businesses can allow credit unions to serve underbanked consumers.

Sometimes compliance and public policy collide.

For example, financial institutions restrict accounts to certain types of businesses because they draw heightened Bank Secrecy Act/anti-money laundering (BSA/AML) oversight—even though those accounts would serve consumers.

A recent U.S. Government Accountability Office (GAO) report found many residents near the Southwest border were losing access to banking services because of "derisking" and branch closures, says Jim Vilker, vice president of president of professional services at CU*Answers.

Derisking is the practice of financial institutions limiting certain services or ending their relationships with consumers to, among other things, avoid perceived regulatory concerns about facilitating money laundering.

The GAO report surveyed a nationally representative sample of 406 financial institutions, which included 115 institutions that operate in the Southwest border region. It found that BSA/AML regulatory concerns "played a role in their decisions to terminate and limit accounts and close branches."

"They found that whole communities are without banking services," says Vilker, who spoke at the 2018 CUNA Bank Secrecy Act Certification Conference, presented with NASCUS.

Vilker notes the important role credit unions play in their communities, and says they should keep that in mind when making risk assessments. But he also acknowledges that BSA officers make decisions in reaction to regulators' wishes.

"Financial inclusion is something we have to consider," he says. "We have to ask ourselves if we've gone too far."

One option to consider: money-service businesses (MSBs). Financial institutions often avoid serving these businesses—which can include check-cashing businesses, foreign currency exchange services, pawnshops, or marijuana dispensaries—due to the regulatory risks they present. But MSBs also provide opportunities for fee income, and often supply vital services for the unbanked and underbanked, such as remittance transfers, stored value cards, money orders, and traveler's checks.

MSBs will pay a premium for banking services because they understand they are a higher risk.

"If you will bank MSBs you can be selective as to who you bank, both by industry and by business," says Doug Dwyer, director of bank consulting for MSB Compliance. "You are the gatekeeper."

MSB fee opportunities include cash vault, deposited items, returns, wire transfers, and automated clearinghouse services.

Entering the MSB market isn't easy, says Dwyer. Serving these businesses requires a significant investment in time, talent, and business planning.

Items that your board needs to address include:

- **Updated** risk assessment policy.
- **Staffing**.
- **Board training**.
- **Governance**.
- **BSA training** and certification.
- **Transaction** monitoring.
- **Negative** news monitoring.

"If you're contemplating getting into the business, be sure you're making the right investments," Dwyer says. "That will gain regulators' confidence as well."

Send us your comments: *directors@cuna.coop*

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