Credit Union Directors NEWSLETTER

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Overdraft fees: Holding the moral high ground

Credit unions' overdraft protection fees are roughly half of banks' rates.

An early financial services trend of 2022 involves big banks announcing plans to eliminate or dramatically reduce overdraft fees. Capital One kicked off the process in December, with Bank of America and Wells Fargo quickly following suit—each of the three putting its own spin on the ball.

These fees have long been a sore point with consumers, are attracting increasing regulatory scrutiny, and have been shown to disproportionately impact a small segment of (presumably lower-income) consumers.

A December Consumer Financial Protection Bureau (CFPB) report found that 9% of consumer accounts pay 80% of these fees. Therefore, it's no surprise the announced changes received widespread media coverage and kudos from some consumer advocacy groups.

Unfortunately, credit unions' positive actions haven't generated the same headlines: $1.2 billion asset Amplify Credit Union in Austin, Texas, and $908 million asset University Credit Union in Los Angeles took similar steps in January. Also, $14 billion asset Alliant Credit Union in Chicago and $1.9 billion asset Westerra Credit Union in Denver also eliminated such fees before the big banks acted.

The fine print

The term "overdraft" itself is somewhat misleading. Many use the term as a catch-all for a pool that includes nonsufficient funds ("NSF" or "bounced check") fees. It also encompasses overdraft protection, the opt-in service through which a financial institution transfers funds from a linked account to cover a negative balance.

The combined NSF/overdraft fee category generated $15.5 billion in 2019, according to CFPB—roughly one-third of it by Wells Fargo, Bank of America, and JPMorgan Chase alone.

Even the Federal Reserve doesn't distinguish between fees triggered by checks versus debit card/ACH transactions, but the rapid ascent of this category clearly mirrors increased debit card use.

A Filene Research Institute report indicates something many of us suspected: Credit unions' overdraft protection fees are roughly half of banks' rates.

> "**CREDIT UNIONS** can point to their superior long-term record on **NSF/OVERDRAFT FEES.**"
>
> Glen SARVADY

The study found other NSF-related credit union rates to be nominally lower as well.

A closer look at the big banks' fine print is also in order. While Capital One appears to have truly zeroed out all "overdraft" categories, Wells Fargo and Bank of America eliminated only the NSF fee—the smaller slice of the pie.

Bank of America reduced its overdraft rate from $35 to $10. Wells Fargo held its fee at $35 but added a

QUICK TAKE for your next board meeting

Consumers' use of Buy Now Pay Later

Buy Now Pay Later (BNPL) products are quickly changing how consumers purchase and pay for products and services. PYMTS' research shows that 20% of consumers—50 million people—have made BNPL purchases in the last year, and 52% are planning to do so in the next year.

Consumers and BNPL products

50 million consumers used BNPL products

70% of current users would be interested in a financial institution-issued BNPL product

36% of those not using BNPL would be interested in a financial institution-issued product

Source: PYMTS, 2021

24-hour grace period to remedy an overdraft.

These are clearly customer-friendly moves, but "eliminated fees" is an overstatement. The changes also aren't effective until March 31.

The largest banks can afford to be more magnanimous on overdrafts, as their diversified portfolios offer more opportunities through which to offset lost revenue.

A complex challenge

Member-centric credit unions face a complex challenge in simultaneously countering big bank messaging while covering the cost to provide a valuable service that involves incremental risk and back-office effort.

Filene's report explores how member segments use overdraft protection and begins a dialogue on alternative models that might better fit their needs.

The challenge for credit unions is to retain the moral high ground, both in reality and in the court of public opinion.

Large banks are staying ahead of regulators by addressing a long-term disadvantage. Despite the volume of their megaphone, the broader financial services industry should not allow these banks to portray their catch-up moves as taking the vanguard on a consumer issue.

Credit unions can point to their superior long-term record on NSF/overdraft fees. They can encourage current and prospective members to read banks' fine print, where they'll likely discover the pocketbook reality doesn't match the headlines.

They can join the growing list of credit unions revisiting their overdraft fee structures—a trend that seems all but inevitable.

Most of all, they can tell the story of proactively seeking new, cost-effective ways to meet the short-term cash-flow needs critical to an important subset of members.

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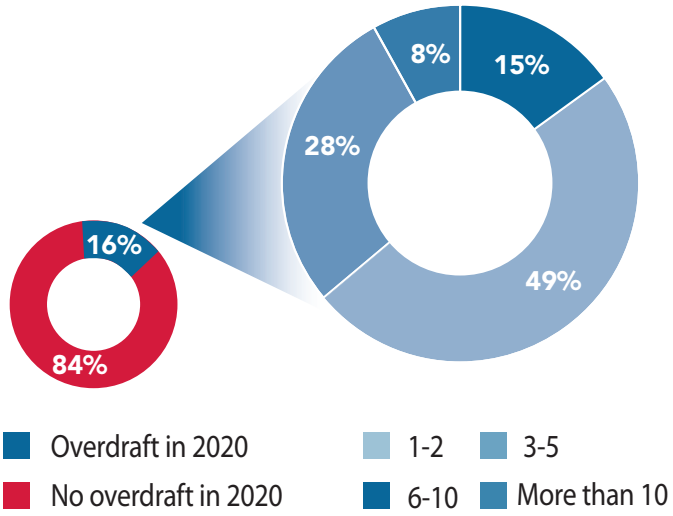
How common are overdrafts?



Source: Financial Health Network, 2021

'How are you telling that story?'

Share how your credit union improves members' financial well-being.

While CUNA Chief Advocacy Officer Ryan Donovan believes credit unions' advocacy success in 2021 sets up advocates nicely for 2022, he envisions it being a challenging year.

All 435 U.S. House of Representatives seats are up in the air, as well as 34 seats in the Senate during November's midterm elections. Currently, the Senate is evenly split between Republicans and Democrats, while Democrats hold a small majority in the House.

"This isn't just any election. It's the first midterm after a new president has taken office, and traditionally the president's party loses seats in their first midterm," Donovan says, adding that the upcoming elections are complicated further because it's also the first midterm election after redistricting.

"On paper, Republicans certainly look like they have the advantage in the redistricting process and—as a result of all these factors—they have an advantage going into the November election," Donovan says.

If it plays out that way, the window of opportunity for Democrats to advance legislation appears to be closing. Donovan expects more action from federal regulators to drive policy in President Joe Biden's direction and to entice base voters to turn out.

This is why Donovan preaches 360-degree advocacy—not just relying on Congress to solve credit unions' problems, but also seeing if advocates can saturate policymakers with their message and make advancements through the regulatory process, state legislators, and the legal arena.

"Advocacy isn't a sport you just observe, it's something that requires participation," Donovan says. "All of these important efforts help us tell the story of how credit unions are working to improve their members' financial well-being and advance the communities they serve.

"How is your credit union measuring the impact it has on your community and your members? How are you telling that story?"

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> "You will come away with a host of ideas to bring back to the board room."
>
> **Mark Photiades**
> Board Chair
> Wings Financial Credit Union

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NCUA issues supervisory priorities for 2022

Examinations will continue to be held primarily off-site.

Credit risk management, cybersecurity, and payment products, services, and operations top the list of NCUA's supervisory priorities for 2022.

The agency issued Letter to Credit Unions 22-CU-02 in January, which outlines these priorities.

It also indicates that examinations and supervisory activities will continue to be held primarily off-site due to the coronavirus pandemic.

"Working with our public health consultant, the agency continues to closely monitor the COVID-19 pandemic trends and will resume on-site examination and supervision work when safe to do so," NCUA Chairman Todd Harper writes in the letter.

NCUA's primary areas of supervisory focus are:

▶**Credit risk management**
NCUA examiners will continue to review credit unions' risk management practices to ensure they are commensurate with the level of complexity and nature of lending activities, and that these practices comply with consumer financial protection laws.

> The agency will resume on-site examination and supervision work when safe to do so.
>
> Todd Harper

▶**Cybersecurity**
NCUA continues to develop updated information security examination procedures that are tailored to institutions of varying size and complexity. The goal is to finalize these procedures in 2022.

▶**Payment products, services, and operations**
This will be an increased area of focus, as changes in payment systems increase the risk of fraud, illicit use, and breaches of data security.

▶**Bank Secrecy Act (BSA) compliance and Anti-Money Laundering (AML)/Countering the Financing of Terrorism (CFT)**
The AML Act will bring several new requirements for credit unions to update their risk-based BSA and AML/CFT policies, procedures, and processes. These requirements will be implemented incrementally throughout 2022.

▶**Capital adequacy and risk-based capital rule implementation**
NCUA examiners will be mindful of the effects of excess share growth on net worth and risk-based capital (RBC) ratios. Examiners will ensure that credit unions are evaluating the impact of their COVID-19 response and relief efforts on their capital position and financial stability. Examiners will also review the accuracy of complex credit unions' reporting for the new data elements required in the RBC schedule of the NCUA Call Report.

▶**Loan loss reserving**
Federal credit unions with less than $10 million in assets are not required to implement current expected credit loss provisions. However, all federal credit unions will be required to have a reasonable reserve methodology.

▶**Consumer financial protection**
The scope of each examination's consumer compliance review is risk-focused and is based on the credit union's compliance record, products and services, and any new or emerging concerns.

Examiners will focus on areas related to:

- **The** coronavirus pandemic
- **Fair** lending
- **Servicemembers** Civil Relief Act
- **Fair** Credit Reporting Act
- **Overdraft** programs

▶**Loan participations**
Examiners will verify that credit unions have evaluated the risk in loan participation transactions and determined how that risk fits within the tolerance levels established by the board.

▶**Fraud**
NCUA will review credit union efforts to deter and detect fraud, including internal controls and separation of duties.

Resources

CUNA Credit Union Board of Directors Conference, Honolulu, May 1-4: *cuna.org/events*

CUNA board and committee solutions: *cuna.org/board*

CUNA economics and statistics: *cuna.org/economics*

CUNA advocacy resources: *cuna.org/advocacy*

5 key themes driving balance sheets

Credit unions should expect to return to pre-pandemic growth levels in 2022.

Credit union financials will continue to be influenced by the dynamics of a coronavirus-centric operating environment in 2022.

"As the economy continues to expand, credit union financials will return to pre-pandemic growth levels," says Dawit Kebede, CUNA senior economist. "But there will be adjustments along the way as we recover from the effects of earlier restrictions and learn to operate within the uncertainty of a continuing global pandemic."

CUNA economists identified five key themes that will drive credit union balance sheets in 2022:

1. Savings growth returns to normal.

Savings increased dramatically during the pandemic as worried consumers put away money, including stimulus checks and unemployment payments, amid an atmosphere of uncertainty.

"Because of social distancing restrictions, people couldn't go out and spend their money," Kebede says. "Now the economy is opening up. People are gathering with friends and family, and are traveling. They're spending money as they carry on with the everyday activities of their lives."

Credit unions ended 2021 with 12.9% savings growth, and CUNA economists predict it will return to 5% in 2022.

2. Low loan-to-share ratios continue.

As consumers saved more, they shied away from taking on debt during the pandemic, although that's changing as the economy improves. At the same time, they paid down debt.

Credit unions' 10-year average loan-to share ratio is about 77%. The overall loan-to-share ratio was 70.4% in 2021, and CUNA economists expect it to rise to 72.9% in 2022.

"As loan growth increases and savings growth dies down a bit, loan-to-share ratios will slowly return to pre-pandemic levels," Kebede says.

3. Loan defaults will rise modestly.

Due to direct government support to households and forbearance rules, credit union loan defaults are low, contrary to the expectations of many.

Sixty-two percent of U.S. households used the second stimulus payment to pay down credit card debt, Kebede says. As a result, delinquency and charge-offs reached historic lows.

As government support expires, default levels will rise slightly, Kebede says, but will remain lower than five-year averages.

4. Higher earnings for some institutions.

Because credit unions expected higher loan default rates during the pandemic, they set aside more for loss provisions.

Reducing loss provisions led to higher earnings during the first half of 2021, although most increases took place at large credit unions.

The overall credit union return on average assets was 0.98% in 2021. CUNA economists project it will be 0.70% in 2022.

5. Capital levels recover.

Credit unions' net worth decreased slightly during the pandemic, Kebede says, as savings outpaced loan growth.

Before the pandemic, credit unions' five-year average net-worth ratio was 10.9%, Kebede says. It was 10.63% in 2021, and he expects it will be 10.3% in 2022.

"As the economy continues to expand, credit union financials will return to pre-pandemic levels."

Dawit Kebede

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